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September 15, 2023

Attachment 10: Incentive arrangements

10.1 Incentive Arrangements

Four incentive schemes may apply to TNSPs under the Rules, specifically the:[81]

1. Efficiency Benefits Sharing Scheme (EBSS);
2. Capital Expenditure Sharing Scheme (CESS);
3. Service Target Performance Incentive Scheme (STPIS);
4. Demand Management Innovation Allowance Mechanism (DMIAM).[82]

In considering whether and how to apply these schemes we identified two issues.

- First, the schemes have been developed for TNSPs which have long been subject to economic regulation (as applied under the Rules) and have largely had no material change in role. This stability allows targets to be set based on historic performance and costs. However, Basslink is undergoing significant change. It is moving from a role of MNSP to a TNSP and is being integrated into a larger organisation. This means using historic data to set performance targets will result in rewards and penalties driven by changes in Basslink's role and operating environment rather than genuine efficiency or performance improvements. This poses an unnecessary risk to both consumers and Basslink.
- Second, the elements of these schemes presume that all TNSPs connect multiple generators with a series of demand centres. In contrast, Basslink is an interconnector operating between regions.

Clause S6A.1.3(2) of the NER provides that a TNSP's Revenue Proposal must contain:

> *the values the Transmission Network Service Provider proposes are to be attributed to the performance incentive scheme parameters for the purposes of the application to the Transmission Network Service Provider of any service target performance incentive scheme that has been specified in a framework and approach paper and that applies in respect of the relevant regulatory control period, and an explanation of how the values proposed to be attributed to those parameters comply with any requirements relating to them set out in that scheme;*

Similarly, the requirements relating to incentive schemes in NER clause SA.1.3(2)-(3C) are each tied to whether the relevant incentive scheme 'has been specified in a framework and approach paper'.

The AER's decision to commence a modified transmission determination process for Basslink omitted the requirement for the AER to make a framework and approach paper under clause 6A.10.1A of the NER. The AER's decision noted that given the limited available precedents, and the differences between Basslink and other transmission networks, the matters that would be dealt with

[81] Rule 6A.4.2(5)-(6A).
[82] The Rules also identify a small-scale incentive scheme but this has not been developed for transmission network service providers.

by a framework and approach paper for Basslink will need to be considered afresh and together with the AER's assessment of Basslink Pty Ltd's revenue proposal.[83]

Given these issues we have considered the application of each scheme and have developed our proposal on the basis that:

1. Schemes (or aspects of schemes) which rely on historic performance commence in the 2030-35 period, after 5-years of data is available from a more stable operating environment. While this results in a temporary delay to the application of the schemes, we believe any detriment is outweighed by the benefits of protecting consumers and Basslink from unnecessary risk from incorrectly calibrated targets;
2. Schemes which are not relevant to an interconnector are not applied; and
3. All other schemes (or aspects) are applied consistent with the AER's general approach.

In turn, we propose that the:

1. EBSS is not applied at all in the 2025-30 period and is applied from the 2030-35 period onward, due to the link between the efficiency targets with the base-step-trend forecasting approach and reliance on historic revealed costs.
2. CESS applies from 2025-30, as the CESS operates by comparing actual and forecast capital expenditure (which is not based on historic spend).
3. STPIS is partly applied in 2025-30 (Network Capability Component) and partly delayed to 2030-35 (Service Component and Market Impact Component) as these latter components rely on historic performance.
4. DMIAM is not applied at all as Basslink has limited scope to undertake demand management activities.
5. The small-scale incentive scheme is not applied at all in the 2025-30 period.

Further details on each scheme are provided below.

10.2 Efficiency Benefits Sharing Scheme

Basslink Pty Ltd proposes not applying the EBSS to the first revenue period, with the EBSS to apply in subsequent revenue periods.

This is because Basslink Pty Ltd considers the application of the EBSS would produce uncertain outcomes rather than incentives on the business. The AER states:

> *The EBSS aims to provide a continuous incentive for NSPs [Network Service Providers] to pursue efficiency improvements in opex and to share efficiency gains between NSPs and network users*

[83] *AER - Notice of decision and commencement and process paper - APA Group BassLink - July 2023*, pp 8-9.

Basslink is undergoing significant change in its operating environment. The two most significant are:

- it is moving from a market operation to a regulated asset with the change in reliability obligations that brings with it; and
- it is moving from operating as a stand alone business to being an integrated part of APA.

These changes mean that the past operating expenditure is not a reliable indicator of future operating expenditure, and so the necessary operating expenditure for the next five years is very difficult to forecast. While every effort has made to forecast this expenditure as robustly as possible, there is significant uncertainty as to what future the operating expenditure will be for Basslink.

The consequence of this uncertainty is that costs may change over time due to these operating environment factors rather than genuine efficiency savings (or losses). This could result in consumers paying more than necessary or Basslink being subject to penalties which are unrelated efficiency losses.

Integration

APA is still undertaking the integration workstreams for incorporating Basslink into APA's operating environment. This project is expected to run for the next year. The full implications of integration on costs and while successfully meeting the obligations of a reliable operator have yet to be worked through, and there remains a lot of uncertainty around the full implications of this process.

Significant aspects of Basslink Pty Ltd's business are being changed and incorporated in APA structures and processes. This is major reform to how Basslink operates. Basslink has not completed a full financial year.

Regulated Status

It has been 17 years since the last electricity transmission interconnector became a regulated asset. There has been significant changes to the regulatory environment since that time. There is significant uncertainty as to the cost effect of the different operating model.

Basslink has identified changes in insurance expense, financial reporting costs, AEMO fees and the costs of economic regulation. It is likely there are other impacts from the change to a regulated network which have not yet been identified.

Incentives

For the reasons outlined above the potential variance is much more significant than could be experienced by other regulated businesses. It is not consistent with the NEO or the purpose of the EBSS to reward or penalise a business for variance that does not reflect the efficiency or inefficiency of the business but rather reflect the significant changes to the structure and operating environment of the business.

The AER states:[84]

> *There are two potential incentive problems with this forecasting approach when an EBSS is not in place:*
>
> *1. A NSP has an incentive to increase opex in the expected 'base year' to increase its forecast opex allowance for the following regulatory control period.*
>
> *2. A NSP's incentive to make sustainable change to its practices, and reduce its recurrent opex, declines as the regulatory control period progresses. It then increases again after the base year used to forecast opex for the following regulatory control period. By deferring these ongoing efficiency gains until after the base year the NSP can retain the benefits of doing so for longer because they won't be reflected in the opex forecasts for the following period.*

We note that:

- In relation to 1, there is no requirement that the AER commence the subsequent forecast using a particular year if there is evidence that the operating expenditure in that year was inflated. Historic operating expenditure dating back to Financial Year 2006 will be reported to the AER so that an appropriate base year can be identified.
- In relation to 2, Basslink Pty Ltd would ask the AER to consider the following matters in determining the weight it would give to this concern:
    - Firstly, the proposal for the EBSS to apply after the first revenue period, which when considered over the life of the asset, represents a relatively short period of time. The EBSS will apply so the changing nature of the incentives will only be for a short period of time.
    - Secondly, if there was a strong representative opex baseline against which to forecast costs then it would be true that the incentive declines over the regulatory period without the EBSS. However, given it is highly likely to be cost differentials between the historic opex of an MNSP standalone Basslink in FY22 and the forecast TNSP part of APA the incentive parameters of the EBSS are weak to begin with.

Difference between Capex and Opex

Capital expenditure and operating expenditure are very different. This directly affects the level of uncertainty in the forecast when a business is changing to a regulated business and being integrated into a larger business.

The forecast capital expenditure program is a bottom-up forecast comprised of a relatively few discrete projects of which only two of which are expected to have expenditure in every year of the revenue period. For an electricity transmission interconnector, the capex program does not involve a lot of repeat activities unlike what an electricity distribution network would experience for example.

[84] 2013 AER, *Efficiency Benefit Sharing Scheme for Electricity Network Service Providers,* p.4

In contrast, operating expenditure involves a large number of repeat or ongoing activities with the forecast developed from a base year of historic spend. The Governance framework for these activities is very different between a small organisation like the former Basslink and APA. There will be economies of scale that will drive down the cost of some activities and there will be a higher level of risk management. There is much greater uncertainty as to whether future operating expenditure will be higher or lower and it will vary from activity to activity and year to year.

This is why Basslink Pty Ltd is proposing the CESS apply to capital expenditure and the EBSS not apply to operating expenditure.

10.3 Capital Expenditure Sharing Scheme

Basslink Pty Ltd is proposing the application of the CESS version 2 for the 2025-30 regulatory control period.

10.4 Service Target Performance Incentive Scheme

The electricity transmission STPIS (version 5) has three components:

- Service Component (SC) – which encourages TNSPs to reduce the number of unplanned network outages and to promptly restore the network in the event of unplanned outages.
- Market Impact Component (MIC) – which provides an incentive to minimise the impact of transmission outages that can affect wholesale market outcomes.
- Network Capability Component (NCC) – which encourages TNSPs to identify suitable low-cost one-off projects that improve the capability of the transmission network at times when it is most needed.

Service Component and Market Impact Component

We propose that the SC and MIC components commence in the 2030-35 period following data collection over the 2025-30 period.

This approach is consistent with the past approach for Directlink, where the STPIS was applied in its second regulatory control period (2015-20) but not the first period following conversion to a regulated interconnector (2006-15).

It is also consistent with the approach taken with the initial development of the STPIS and preceding Service Standards. The ACCC 'strongly suggested' networks to begin collecting 5 years of performance information on a range of measures in its January 2000 decision for the NSW and ACT Network Revenue Caps.[85] Similarly, the AER only introduced measures of congestion in the STPIS following a series of work together with NEMCO over 2003/04, 2004/05 and 2005/06[86] before being introduced in the STPIS in August 2007.[87]

[85] ACCC 2000, *NSW and ACT Transmission Network Revenue Caps 1999/00-2003/04,* Available here.
[86] As outlined here.
[87] AER 2007, *Final Decision, Electricity Transmission Network Service Providers, Service Target Performance Incentive Scheme.* Available here.

Over the 2025-30 period, Basslink Pty Ltd will provide the AER with the information on a basis consistent with the requirements for data in STPIS version 5 to enable their performance against those targets in the subsequent regulatory control period.

We also propose that the SC and MIC are applied in 2030-35 consistent with how these elements are applied for Murraylink and Directlink in version 5 of the STPIS. This adjustment is required to reflect that Basslink is an interconnector rather than a network with multiple generation and demand points.

Network Capability Component

The last component of the STPIS is the NCC. The purpose of the NCC is to facilitate improved capability of the transmission system in respect to spot prices and when users place the greatest value on system reliability.[88]

The NCC requires the submission of a Network Capability Incentive Parameter Action Plan (NCIPAP) which identifies the limits and a set of priority projects to improve these limits. TNSPs must consult with AEMO prior to submitting a NCIPAP as part of their revenue proposal and submit an annual compliance report.

This scheme is also applicable to interconnectors. While there are generally less circuits and injection points, interconnector limits have a material impact on the energy system, and in turn market and consumer outcomes.

In the case of Basslink, the key limit is the ambient temperatures at the Loy Yang and George Town converter stations. High ambient temperatures constrain power transfer in extreme weather conditions; however, it is these conditions which also lead to the wider energy system being under the most pressure.

In 7 out of the top 10 Victorian peak demand days since Basslink was commissioned ambient temperatures either limited or were forecast to limit power transfer. On the Victorian record demand day of 29 January 2009, when 420MW of customer load was curtailed across South Australia and Victoria, Basslink was unable to transfer energy from Tasmania to support the wider system for a short period.

Given that historic data is not required for the NCC to effectively operate and that the NCC can bring benefits to interconnectors we propose that it applies to Basslink in the 2025-30 period.

We have developed a NCIPAP (**Attachment 13**) and consulted with AEMO.[89] The NCIPAP outlines network limits and, at this stage, does not include any priority projects.

While no projects have been included, applying the NCC to Basslink would help facilitate mid-period future projects which would result in a material benefit. To add a project to the NCIPAP, Basslink is required to consult with AEMO[90] (and would consult other stakeholders as required) and request that the AER accept that the project be included.[91]

We note that the current STPIS states that the NCC does not apply to Directlink and Murraylink.[92] This does not prevent the NCC from applying to Basslink. We also note the risks of applying the scheme to Basslink are minimal (given the engagement requirements with AEMO together with AER

[88] STPIS clause 5.2
[89] A letter from AEMO on our proposed NCIPAP is provided in **attachment 13**
[90] STPIS clause 5.4(e)
[91] STPIS clause 5.4(b)
[92] STPIS Clause 2.2(d)

oversight to ensure that potential projects deliver material benefits). In contrast, not applying the NCC would prevent or delay projects which could deliver higher levels of reliability and lower spot times – at times of (increasingly) extreme weather.

10.5 Demand Management Innovation Allowance Mechanism

Basslink Pty Ltd is not proposing to apply the Demand Management Innovation Allowance Mechanism. The circumstances for Basslink are the same for Directlink and Murraylink.

In its draft determination for the Murraylink Transmission Determination the AER stated:[93]

> *Under the current operational framework, we consider that there will be very limited utility to energy users were Murraylink to invest in researching demand management opportunities through the DMIAM.*
>
> *Demand management is typically achieved through load shifting, increasing the level of embedded generation sources, and to a lesser extent minimising energy losses. Murraylink is a point-to-point interconnector between South Australia and Victoria. The power flowing through this link is determined by the price differential between the two regions and other network constraint factors at the time of generation dispatch by AEMO. There is no scope for Murraylink to manage the power flow volume by load shifting or to connect new embedded generators. Nor can it reduce losses within the link without some sort of capital investment. Given the DMIAM does not allow capex expenditure under the mechanism, the scope for loss reduction under the DMIAM is limited. Therefore it is not appropriate to apply a DMIS*

This is equally true for Basslink. Demand Management would have to be achieved at the regional level. There is no scheme that Basslink could identify that would achieve that outcome in a way that is proportionate to the benefit or would not require significant capital expenditure.

10.6 Small-scale incentive scheme

For completeness, Basslink Pty Ltd does not seek to propose any small-scale incentive scheme for the forthcoming regulatory control period.

[93] 2022 AER, *Draft Decision, Murraylink Transmission Determination 2023 to 2028,* p.14 Available here.

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Attachment 11: Cost Pass Throughs

11.1 Executive Summary

The Rules provide an avenue to pass through costs incurred by a Network Service Provider (NSP) in connection with prescribed or approved events beyond our control. This regulatory framework recognises that there are unpredictable events which may impose high costs on the NSP. Customers are protected from paying these high costs for low probability events that are beyond a NSP's control.

We propose the following nominated pass through events for the 2025-30 period, which are discussed in turn at sections 3 to 8 below:

- Insurance coverage event
- Insurer credit risk event
- Natural disaster event
- Terrorism event
- REZ design report event
- Offshore project assessment event.

Each of these proposed nominated pass through events have been selected with the aim of promoting prudent and efficient risk mitigation so that we can safely, reliably and securely supply our customers. When preparing our proposal for the above nominated pass through events, we have been guided by:

- the nominated pass through event considerations outlined in the Rules, and
- stakeholder engagement sessions where we discussed, among other things, rising insurance premiums and high deductible levels, with particular reference to the offshore property (subsea cable) insurance.

11.2 NER Requirements

Clause 6A.7.3(a1) of the Rules provides that any of the following is a pass through event for a transmission determination:

> (1) a regulatory change event;
> (2) a service standard event;
> (3) a tax change event;
> (4) an insurance event;
> (5) any other event specified in a transmission determination as a pass through event for the determination; and
> (6) an inertia shortfall event.[94]

Clause 6A.6.9 provides that a Revenue Proposal may include a proposal as to the events that should be defined as 'pass through events' under clause 6A.7.3(a1)(5), having regard to the nominated pass through event considerations. The Rules provides that the nominated pass through event considerations are:

[94] Paragraph (6) does not apply in Victoria.

- Whether the event proposed is covered by a category of pass-through event specified in NER clause 6A.7.3(a1)(1)-(4);
- Whether the nature or type of event can be clearly identified at the time the determination is made for the NSP;
- 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 reasonably insure against the event or whether the event can be self-insured; and
- Any other matter the AER considers relevant and which the AER has notified NSPs as a nominated pass-through event consideration.

We have been guided by these considerations in preparing our nominated cost pass through event proposal for the 2025-30 regulatory control period.

11.3 Insurance coverage event

Including an insurance coverage event as a relevant event protects Basslink from losses if an insurer is not liable to pay all, or part, of a large or catastrophic event that could have a financially significant impact.

There is inherent volatility in the liability insurance market (particularly in respect of bushfire liability) and the offshore property market (particularly in respect of subsea cables). Including this category of event is intended to cover potential insurance gaps and the possibility of withdrawn capacity or uneconomic increases in premiums in the future.

Scope of proposed pass through event

Basslink Pty Ltd's proposed definition for our nominated 'insurance coverage event' is set out below and is consistent with the AER's recent determinations.[95] The definition is cognisant of the AER's preferred drafting and does not propose any deviations from recently approved definitions of an 'insurance coverage event'.

[95] AER, *ElectraNet transmission determination 2023-28*, Attachment 11 – Pass through events (Final decision, 28 April 2023); AER, *AusNet transmission determination 2022-27*, Attachment 11– Pass through events (Final decision, 28 January 2022); AER, *Transgrid transmission determination 2023-28*, Attachment 11 – Pass through events (Final decision, 28 April 2023).

An insurance coverage event occurs if:

1. *Basslink:*
    a. *makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy or set of insurance policies; or*
    b. *would have been able to make a claim or claims under a relevant insurance policy or set of insurance policies but for changed circumstances; and*
2. *Basslink incurs costs:*
    a. *beyond a relevant policy limit for that policy or set of insurance policies; or*
    b. *that are unrecoverable under that policy or set of insurance policies due to changed circumstances; and*
3. *The costs referred to in paragraph 2 above materially increase the costs to Basslink in providing prescribed transmission services.*

For the purposes of this insurance coverage event:

'changed circumstances' means movements in the relevant insurance market since the acquisition of the insurance policy or set of insurance policies that applied during the majority of Basslink's base year and that are beyond the reasonable control of Basslink, where those movements result in it no longer being prudent or efficient for Basslink to take out with a reputable insurer:

i. *a relevant insurance policy; or*
ii. *in the case of a set of insurance policies, one or more layers of insurance within that set (or there are otherwise one or more gaps within the set), either at all or on commercial terms reasonable to Basslink.*

'costs' means the costs that would have been recovered under the insurance policy or set of insurance policies had:

i. *the limit not been exhausted;*

those costs not been unrecoverable due to changed circumstances.

A 'relevant insurance policy' or 'set of insurance policies' is an insurance policy or set of insurance policies held during the regulatory control period or a previous regulatory control period in which Basslink was regulated; and

i. *Basslink will be deemed to have made a claim on a relevant insurance policy or set of insurance policies if the claim is made by a related party of Basslink in relation to any aspect of Basslink's network or business; and*
ii. *Basslink will be deemed to have been able to make a claim on a relevant insurance policy or set of insurance policies if, but for changed circumstances, the claim could have been made by a related party of Basslink in relation to any aspect of Basslink's network or business.*

Note for the avoidance of doubt, in assessing an insurance coverage event through application under rule 6A.7.3(j), the AER will have regard to:

i. *the relevant insurance policy or set of insurance policies for the event;*
ii. *the level of insurance that an efficient and prudent Transmission Network Service Provider (TNSP) would obtain, or would have sought to obtain, in respect of the event;*
iii. *any information provided by Basslink to the AER about Basslink's actions and processes; and*
iv. *any guidance published by the AER on matters the AER will likely have regard to in assessing any insurance coverage event that occurs.*

Rationale

An insurance coverage event is a prudent and efficient way to mitigate the risk of Basslink incurring losses exceeding our insurance coverage or for gaps in the insurance coverage caused by withdrawn capacity or where the cost of coverage cannot be economically justified. We believe this is a pragmatic approach to balancing risks for the following reasons:

Basslink operates within the business' risk framework to reasonably withstand unpredictable events outside of our control. Our insurance limits are commensurate with risks associated with our operations and customers, as well as industry standards. In some instances, the cost of insurance to mitigate the risk is only available at a prohibitively high cost given the probability of the event occuring.

Furthermore, it may not be possible to take out an insurance policy at all for these types of improbable events, and/or on reasonable commercial terms over the 2025-30 regulatory period. This has been made more difficult in recent times given the volatility of the global and domestic insurance industry. This volatility has driven up the cost of insurance premiums and influences insurers to reassess the cover they are willing to provide. These factors are outside of our control and cannot reasonably be prevented by a TNSP.

Without a pass through provision, Basslink Pty Ltd will need to set aside additional annual insurance allowance to address these risks. In turn, this means our customers would bear additional costs irrespective of whether such an event actually occurs.

As part of our stakeholder engagement sessions, we discussed the risks and concerns around rising insurance premiums and high deductible levels (with particular reference to the offshore property (subsea cable) insurance.

An insurer coverage event is not already covered by any of the categories of pass through events specified in the NER.

We are therefore proposing an insurance coverage event to protect Basslink in the event that our insurer is not liable to pay all, or part of, a loss which materially impacts our costs. This pass through event will provide us with a reasonable opportunity to recover the efficient costs incurred as a result of unpredicted insurance market conditions, while not imposing costs on consumers for the sort of 'low probability, high cost to insure' events contemplated.

11.4 Insurer credit risk event

An insurance credit risk event mitigates the risk of an insurer becoming insolvent, and as a result forcing Basslink Pty Ltd to insure with another provider and incurring substantial additional costs beyond our control. Additional costs may include higher premiums, a lower claim payment or higher deductible.

Scope of pass through event

Our proposed definition for our nominated 'insurer credit risk event' is below and is consistent with the AER's recent determination.[96] The definition is cognisant of the AER's preferred drafting and does not propose any deviations from recently approved definitions of an 'insurer credit risk event'.

An insurer credit risk event occurs if an insurer of Basslink becomes insolvent, and as a result, in respect of an existing or potential claim for a risk that was insured by the insolvent insurer, Basslink:

a) is subject to a higher or lower claim limit or a higher or lower deductible than would have otherwise applied under the insolvent insurer's policy; or

b) incurs additional costs associated with funding an insurance claim, which would otherwise have been covered by the insolvent insurer.

Note: in assessing an insurer credit risk event pass through application, the AER will have regard to, amongst other things:

i. Basslink's attempts to mitigate and prevent the event from occurring by reviewing and considering the insurer's track record, size, credit rating and reputation; and

ii. *In the event that a claim would have been covered by the insolvent insurer's policy, whether Basslink had reasonable opportunity to insure the risk with a different provider.*

Rationale

An insurer credit risk pass through event is a prudent and efficient way to mitigate the risk with our customers, while providing us with a reasonable opportunity to recover the efficient costs incurred as a result of unpredicted insurance market conditions. This type of event cannot be reasonably insured against (in part, or at all) by an NSP on reasonable or commercial or economic terms. An insurer credit risk event is also not already covered by any of the categories of pass through events specified in the Rules.

Basslink Pty Ltd cannot reasonably prevent our insurer becoming insolvent or substantially mitigate the cost impact of such an unpredictable event. As an NSP, we have significant insurance coverage for Basslink. If, for reasons beyond our control, an insurer is unable to pay all, or a part of, a claim, this would significantly impact our ability to deliver services to our customers. The occurrence of increased insurance premiums from alternative insurers (where the original insurer becomes insolvent) is also beyond our control.

Basslink Pty Ltd minimises insurer credit risk by using an insurance broker to obtain our insurance coverage. Our broker has minimum financial guidelines for insurers which typically requires an interactive S&P rating of BBB or higher and the local currency equivalent of US$50 million in unencumbered policyholders' surplus. Typically, insurers for Basslink are rated S&P A- or higher and

[96] AER, *ElectraNet transmission determination 2023-28*, Attachment 11 – Pass through events (Final decision, 28 April 2023); AER, *AusNet transmission determination 2022-27*, Attachment 11 – Pass through events (Final decision, 28 January 2022); AER, *Transgrid transmission determination 2023-28*, Attachment 11 – Pass through events (Final decision, 28 April 2023).

Basslink Pty Ltd has access to a live portfolio view of all insurers and their respective financial security rating. In addition, Basslink Pty Ltd receives quarterly insurer portfolio listings and alerts when insurers in the portfolio are subject to a rating change.

11.5 Natural disaster event

A natural disaster event is a prudent and efficient way to mitigate the risk of unpredictable and extreme events that are undoubtedly beyond an NSP's control.

Scope of proposed pass through event

Our proposed definition for our nominated 'natural disaster event' is set out below and is consistent with the AER's recent regulatory decisions.[97] Our definition below is cognisant of the AER's preferred drafting and does not propose any deviations from approved definitions of a 'natural disaster event'.

Natural disaster event means any natural disaster including but not limited to cyclone, fire, flood or earthquake that occurs during the 2024-29 regulatory control period that changes the costs to Basslink in providing prescribed transmission services, provided the cyclone, fire, flood, earthquake or other event was:

a) a consequence of an act or omission that was necessary for Basslink to comply with a regulatory obligation or requirement or with an applicable regulatory instrument, or
b) not a consequence of any other act or omission of Basslink.

Note: In assessing a natural disaster event pass through application, the AER will have regard to, among other things:

i. whether Basslink has insurance against the event, and
ii. the level of insurance that an efficient and prudent Network Service Provider would obtain in respect of the event.

Rationale

A natural disaster event mitigates the risk of not being able to obtain insurance coverage for natural disaster events and materially increasing our efficient costs that are unable to be recovered by the NSP. Basslink Pty Ltd cannot prevent this type of event from occurring and cannot substantially mitigate the cost impacts of this type of event (both prior to and after the occurrence of the event). A natural disaster event is also not already covered by any of the categories of pass through events specified in the Rules.

As an NSP, we employ a wide array of strategies to manage Basslink's exposure to natural disasters and mitigate the consequences of this exposure. Our insurance broker has advised that most NSP's do not purchase coverage for assets such as poles and wires / towers and lines. This is due to a lack

[97] AER, *ElectraNet transmission determination 2023-28*, Attachment 11 – Pass through events (Final decision, 28 April 2023); AER, *AusNet transmission determination 2022-27*, Attachment 11 – Pass through events (Final decision, 28 January 2022); AER, *Transgrid transmission determination 2023-28*, Attachment 11 – Pass through events (Final decision, 28 April 2023).

of insurance market appetite for these types of assets as they are heavily exposed to natural disasters (such as windstorms, cyclones and bushfires). If insurance is available, it is typically on uneconomic terms.

Other assets which are insured are often subject to sub limits for flood and earthquake and these perils often carry higher policy deductibles. Somewhat uniquely, Basslink has managed to procure efficient coverage for its towers and lines by leveraging the scale of its parent company's property insurance program combined with the limited kilometres of towers and lines associated with Basslink. However, ongoing coverage for these assets is not guaranteed. Therefore, complete insurance cover for natural disaster events for assets like Basslink is potentially not available, or not available at an efficient cost. This means Basslink Pty Ltd cannot always obtain appropriate insurance on reasonable commercial terms covering the full range of costs that could potentially be incurred as a result of a natural disaster event.

The occurrence of a natural disaster event (as defined above) has a low probability of occurrence but a high consequence or magnitude. Accordingly, self-insurance would not be appropriate to obtain given the need to balance the long-term interests of customers against rising insurance premiums and likelihood of a natural disaster event occurring.

11.6 Terrorism event

A terrorism event mitigates the risk of liability arising from devastating and deliberate damage caused to our network which risks our ability to deliver prescribed transmission services to customers.

Scope of proposed pass through event

Our proposed definition for our nominated 'terrorism event' is below and is largely consistent with the AER's recent regulatory decisions.[98]

Terrorism event

Terrorism event means an act (including, but not limited to, the use of force or violence, or the threat of force or violence, or a malicious act to access and/or disrupt computer systems or other information communication technologies including operational technology systems) of any person or group of persons (whether acting alone or on behalf of or in connection with any organisation or government), which:

a) 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
b) changes the costs to Basslink in providing prescribed transmission services.

Note: In assessing a terrorism event pass through application, the AER will have regard to, amongst other things:

i. whether Basslink has insurance against the event;
ii. the level of insurance that an efficient and prudent Network Service Provider would obtain in respect of the event; and
iii. whether a declaration has been made by a relevant government authority that a terrorism event has occurred.

Rationale

A terrorism event is also not already covered by any of the categories of pass through events specified in the Rules. The occurrence of a particular terrorism event (including a cyber-terrorism attack) has a low probability of occurrence but may have significant financial consequence or magnitude. In recent determination decisions, the AER has approved a terrorism cost pass through event for TNSPs in their preferred drafting.[99]

Basslink is subject to new obligations in relation to cyber security and critical infrastructure resilience over the 2025-30 regulatory period.[100] We have set out in **Attachments 7 and 8** expenditure required to meet our new regulatory obligations that aim to prevent and mitigate the risk of a cyber-terrorism event occurring.

We agree with the AER that a TNSP is best placed to manage the majority of the risks posed by cyber terrorism attacks. As much as practicably possible, Basslink Pty Ltd is committed to

[98] AER, *ElectraNet transmission determination 2023-28*, Attachment 11 – Pass through events (Final decision, 28 April 2023); AER, *AusNet transmission determination 2022-27*, Attachment 11 – Pass through events (Final decision, 28 January 2022); AER, *Transgrid transmission determination 2023-28*, Attachment 11 – Pass through events (Final decision, 28 April 2023).
[99] AER, *ElectraNet transmission determination 2023-28*, Attachment 11 – Pass through events (Final decision, 28 April 2023); AER, *AusNet transmission determination 2022-27*, Attachment 11 – Pass through events (Final decision, 28 January 2022); AER, *Transgrid transmission determination 2023-28*, Attachment 11 – Pass through events (Final decision, 28 April 2023).
[100] *Security of Critical Infrastructure Act 2018* (Cth); AEMO, *Australian Energy Sector Cyber Security Framework* (December 2022).

maintaining robust and resilient network systems to mitigate the risk and cost impact of this type of event. Notwithstanding the new cyber security and protection measures taken to meet the above obligations and beyond, an act of cyber terrorism could still significantly impact Basslink's ability to deliver prescribed services. It is not possible to eliminate the entirety of the risks we face when it comes to a cyber terrorism attack. It would be neither prudent nor efficient to incur material costs to insure against this type of event, which would inevitably mean additional costs to our customers.

Additionally, our insurance broker has advised that the global insurance market landscape for cyber risk is rapidly evolving, where obtaining insurance for a cyber-terrorism attack is increasingly challenging for critical infrastructure assets like Basslink.

Terrorism event definitions recently approved by the AER only refer to physical acts such as 'the use of force or violence, or the threat of force or violence'. Remaining silent on non-physical terrorist events such as cyber-terrorism attacks raise uncertainty in interpreting this event. Providing certainty will also ensure Basslink can continue to meet its regulatory obligations without curtailing our ability to provide safe, reliable and affordable services to customers.

Accordingly, we propose a small amendment to the preferred drafting of this event to make clear that cyber terrorist attacks explicitly fall under this pass-through event. In the recent AusNet draft decision (and previous decisions for distribution businesses), we note the AER has suggested cyber-terrorism be included in a nominated terrorism pass through event[101]:

> *'…As noted in our previous decisions for distribution businesses, the nominated 'terrorism' pass through event could include cyber-terrorism. Given the likely impacts as set out above that a major cyber-attack usually involves, this intended inclusion should cover a high proportion of risks likely to be faced...'*

Considering the AER has previously contemplated such non-physical events may fall under this pass through event, we propose the AER accept our terrorism event definition which explicitly includes cyber attacks in a limited manner.

11.7 REZ design report event

Basslink Pty Ltd proposes a new pass through event for the 2025-30 regulatory period to enable Basslink to recover costs incurred in preparing a REZ design report.

[101] AER, *AusNet transmission determination 2022-27*, Attachment 11 – Pass through events (Draft decision, 30 June 2021).

Scope of proposed pass through event

Our proposed definition for our nominated 'REZ design report event' is below.

A REZ design report event occurs if:

a) *Basslink is required to commence preparation of one or more Renewable Energy Zone (REZ) design reports in accordance with clause 5.24.1(b) of the National Electricity Rules; and*
b) *Basslink will incur additional material costs in preparing for one or more offshore project assessment events, the recovery of which was not included in the maximum allowed revenue that Basslink may earn from the provision of prescribed transmission services during the 2024-2029 regulatory control period.*

Note: in assessing a REZ design report event pass through application, the AER will have regard to, amongst other things:

1. *the need to ensure that Basslink has a reasonable opportunity to recover the total efficient costs of an offshore project assessment event; and*

   the urgency of the request to complete the assessment and/or report(s).

Rationale

A REZ design report event will occur if AEMO requests Basslink Pty Ltd to prepare a design report for a REZ in Tasmania in the release of an Integrated System Plan (ISP) in the 2025-30 regulatory period. This type of event is not already covered by any of the categories of pass through events specified in the Rules and cannot be clearly identified.

REZs are subject to a special planning regime, which includes the preparation of REZ design reports by Jurisdictional Planning Bodies. Under this regime, an ISP may require a design report to be prepared for a REZ in Tasmania.

As the decision to prepare a REZ design report is the responsibility of AEMO, Basslink Pty Ltd has no control over whether one or more reports will be required during the 2025-30 regulatory period. Under these rules, AEMO may trigger a requirement for Basslink Pty Ltd to prepare a REZ design report that was not predicted at the time of the AER's determination decision.

Our proposal to include REZ design reports is also consistent with the Energy Security Board's recommendations on nominating a pass though event for the preparation of REZ design reports[102]:

The ESB recommends that the cost pass through mechanism applies in the event that the TNSP is required to prepare a REZ design report and the AER did not forecast the project in the TNSP's previous revenue determination

[102] Energy Security Board, *Renewable Energy Zones Planning, Final Recommendations* (February 2021).

While we cannot predict when this type of event will occur in the 2025-30 regulatory period, we have proposed this cost pass through event having regard to recent policy and industry developments. Governments and market bodies have indicated the following developments which may impact Basslink's operations and costs associated with delivering a REZ design report:

- Tasmanian Government's announcement to explore the north west of Tasmania as the first potential region to host the State's first REZ.[103]
- Tasmanian Government's proposed offshore wind energy zone for the Bass Strait region off Northern Tasmania by Federal Energy Minister Chris Bowen[104]
- ISPs are published by AEMO biennially. One ISP is due to be finalised in 2024 and two ISPs are due for release in 2026 and 2028 during Basslink's proposed regulatory period. AEMO's trigger may arise from any of these ISPs during the regulatory period.

Basslink Pty Ltd accepts the AER's position in its draft decision on ElectraNet's transmission determination for the 2023-2028 regulatory period that the NER's definition of a positive change event requires the application of the materiality threshold, and that this requirement may not be bypassed in the definition for a proposed nominated pass through event. We consider this event to bear genuine risks and therefore accept the AER's rationale to not waive the materiality threshold for our proposed definition.

Basslink Pty Ltd cannot prevent this type of event from occurring, nor can it substantially mitigate the cost impacts of this type of event (both prior to and after the occurrence of the event). The occurrence of a REZ design report event has a low probability of occurrence but a high consequence or magnitude. Obtaining appropriate insurances on reasonable commercial terms covering the full range of costs that could potentially be incurred for this type of event is also not possible, particularly given the inability to predict the magnitude, scope and frequency of the event.

11.8 Offshore project assessment event risking continued operation of Basslink

Basslink Pty Ltd proposes a new pass through event for the 2025-30 regulatory period to enable Basslink Pty Ltd to recover costs incurred in preparing offshore resource project assessments within a defined radius.

[103] Tasmanian Government, https://www.renewableenergyzones.tas.gov.au/about_rez
[104] Unlocking the power of offshore wind | Ministers (dcceew.gov.au)

Scope of proposed pass through event

Our proposed definition for our nominated 'offshore project assessment event' is below.

An offshore project assessment event occurs if:

a) Basslink is required to commence preparation of one or more assessment reports for an offshore resource project(s) within 2 nautical miles either side of Basslink (being 4 nautical miles in total); and
b) Basslink will incur additional material costs in preparing for one or more offshore project assessment events, the recovery of which was not included in the maximum allowed revenue that Basslink may earn from the provision of prescribed transmission services during the 2024-2029 regulatory control period.

Note: in assessing an offshore project assessment pass through application, the AER will have regard to, amongst other things:

a. the need to ensure that Basslink has a reasonable opportunity to recover the total efficient costs of an offshore project assessment event; and
a. the urgency of the request to complete the assessment and/or report(s).

Rationale

Continued operation of Basslink is critical to ensuring a reliable, affordable and secure supply to customers in Tasmania and the National Electricity Market (NEM). To protect Basslink and associated services we provide to customers, we must have a specific and appropriate 'protection zone' from the potentially significant impacts of future offshore resources projects.

Our proposed definition aims to minimise any material impact on costs for us and consumers across the NEM. Basslink provides Victoria, and the NEM more broadly, with access to Tasmania's cheaper hydropower and wind power at its peak periods or when dams are overfilled. Basslink also provides Tasmania with access to Victoria's cheaper renewable and baseload power when water levels are low in Tasmania. Being able to 'smooth out' power supply and demands between Victoria and Tasmania also reduces the extent of large price variations.

Basslink is recognised as critical infrastructure. Following advice from experts, Basslink Pty Ltd considers that works within 2 nautical miles either side of Basslink (being 4 nautical miles in total) are a risk to the continued operation of the asset. Basslink's current and potential augmented capacity will be impacted, where potential damage to the asset caused by works within this parameter may significantly risk Basslink's operations and ability to deliver services to customers.

The proposed 4 nautical mile radius is considered appropriate given:

- length of the repair vessel (150-200m)
- length of the cable repair
- a safe operating envelope of the vessel

- overlapping safety zones from other surrounding infrastructure required by the National Offshore Petroleum Safety and Environmental Management Authority (NOPSEMA) (up to 500m).

Works within the zone can also impede the repair of the cable if it is damaged. The size of the zone has been determined in line with the length of the repair vessel, maritime safety zones (both for the vessel and in respect of NOPSEMA safety zones) and anticipated length of cable repairs.

Basslink Pty Ltd has previously proposed a number of principles to mitigate the potentially significant risks posed by offshore developments on Basslink, which include but are not limited to:

- no export cables should cross Basslink
- no other power cables should cross Basslink for safety, system security and operational reasons. If this is unavoidable, any cable crossings must be mechanically, thermally and electrically separated.
- electrical interaction can create dangerous and destruction outcomes to personnel and equipment. Cable crossing and/or in close proximity must be designed and installed to ensure no induction of electricity from another operator's cables to Basslink and vice-versa.
- design and construction of any cables crossing Basslink must also take into account and not impinge on or delay the repair of Basslink.

The proposed definition of an offshore project assessment event enables Basslink Pty Ltd to recover costs incurred which are beyond our control. The preparation and commencement of private offshore project assessments within the 2 natural miles either side of cannot be predicted prior to the AER's determination decision, nor do project proponents have any obligation to consult with Basslink on offshore project proposals unless specified otherwise.

While Basslink will make every reasonable attempt to recover the cost of the project from the proponent there are circumstances that Basslink will either have no basis under which it can require a project proponent to pay the costs or the cost of pursuing the cost from the project proponent are disproportionate to the cost of the offshore project assessment.

Basslink Pty Ltd cannot prevent this type of event from occurring, nor can it substantially mitigate the cost impacts of this type of event (both prior to and after the occurrence of the event). This type of event is not already covered by any of the categories of pass through events specified in the NER and cannot be clearly identified.

While we cannot predict when this type of event will occur, we have proposed this cost pass through event having regard to recent announcements and project developments.[105]

The occurrence of an offshore project assessment event has a low probability of occurrence but a high consequence or magnitude. Basslink Pty Ltd cannot obtain appropriate insurances on reasonable commercial terms covering the full range of costs that could potentially be incurred as a result of this type of event.

[105] Nexsphere and Equinor's planned Bass Offshore Wind Energy project for North-East Tasmania; BayWA r.e.'s application for Offshore Feasibility Licence