

# Draft Decision

Essential Energy

Electricity Distribution

Determination 2024 to 2029

(1 July 2024 to 30 June 2029)

Attachment 15  
Pass through events

September 2023

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#### **Amendment record**

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## 15 Pass through events

During the regulatory control period Essential Energy (Essential) can apply to pass through to its customers, in the form of higher or lower network charges, certain material changes in its efficient costs caused by pre-defined exogenous events. These events are called cost pass through events. Such events are limited to circumstances where the business can recover potential costs of defined yet unpredictable high-cost events that are outside the control of the business.

The National Electricity Rules (NER) prescribe the following pass through events for all distribution determinations:<sup>1</sup>

- a regulatory change event
- a service standard event
- a tax change event
- a retailer solvency event.

In addition to these prescribed events, other pass through events may be 'nominated' by a service provider for a regulatory control period.<sup>2</sup> This attachment sets out our draft decision on the nominated pass through events to apply to Essential Energy's distribution network for the 2024–29 regulatory control period.

### 15.1 Draft decision

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

- accept four of the five nominated pass through events proposed by Essential (terrorism, insurance coverage, insurer credit risk, natural disaster) but with amended definitions to provide consistency between our determinations for Essential and other network service providers.
- Not accept the 'major cyber' pass through event proposed by Essential. We consider it is appropriate for network service providers to be incentivised to mitigate the risk of major cyber events occurring.<sup>4</sup>

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

### 15.2 Essential's proposal

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

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

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

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

<sup>4</sup> For example, AER, Final Decision – AusNet Services distribution determination 2021–26 – Attachment 15 – Pass through events, April 2021, pp. 16–19; AER, Final Decision – CitiPower distribution determination 2021–26 – Attachment 15 – Pass through events, April 2021, pp. 13–16.

**Table 15.1 Essential's nominated pass through events**

Proposed event	Essential's proposed definition
Insurance coverage event	<p>An insurance coverage event occurs if:</p> <ol style="list-style-type: none"> <li>1. Essential makes a claim or claims, and receives a payment or payments, under a relevant insurance policy</li> <li>2. Essential incurs costs beyond a relevant policy limit, or which otherwise fall outside the scope of the cover provided, under the relevant insurance policy or program of insurance policies</li> <li>3. the costs are beyond the policy limit, or otherwise outside the scope of the cover provided, under the relevant insurance policy or program of insurance policies increase the costs to Essential in providing direct control services</li> <li>4. the relevant policy limit is the greater of: <ol style="list-style-type: none"> <li>a. Essential's actual policy limit (or sub-limit) at the time of the event that gives, or would have given, rise to a claim</li> <li>b. the policy limit that is explicitly or implicitly commensurate with the allowance for insurance premiums that is included in the forecast operating expenditure allowance approved in the AER's final decision for the regulatory period in which the insurance policy is issued</li> </ol> </li> <li>5. a relevant insurance policy is an insurance policy held during the 2024–29 regulatory period or a previous regulatory period in which Essential was regulated.</li> </ol> <p>To avoid doubt, in assessing an insurance coverage event cost pass through application under rule 6.6.1 (j), the AER will have regard to:</p> <ol style="list-style-type: none"> <li>1. the insurance premium proposal we submit in our Regulatory Proposal</li> <li>2. the forecast operating expenditure allowance approved in the AER's final decision</li> <li>3. the reasons for that decision.</li> </ol>
Insurer's credit risk event	<p>The insolvency of a nominated insurer of Essential as a result of which Essential:</p> <ol style="list-style-type: none"> <li>1. incurs materially higher or lower costs for insurance premiums than those allowed for in its distribution determination</li> <li>2. in respect of a claim for a risk that would have been insured by Essential's insurers, is subject to a materially higher or lower claim limit or a materially higher or lower deductible than would have applied under that policy.</li> </ol>
Natural disaster event	<p>Any natural disaster event or series of related events, including but not limited to major fire, flood, earthquake or government-declared state of emergency, beyond the reasonable control of Essential that occurs during the 2024–29 regulatory period and materially increases the costs to Essential of providing direct control services,</p>

Proposed event	Essential's proposed definition
	<p>provided the event was not a consequence of a negligent act or omission of the service provider.</p> <p>The term 'major' in the above paragraph means an event that is serious and significant. It does not mean material as that term is defined in the NER (that is, 1 per cent of the DNSP's annual revenue requirement for that regulatory year).</p> <p>Note: In assessing a natural disaster event pass through application, the AER will have regard to:</p> <ol style="list-style-type: none"> <li>1. whether Essential has insurance against the event</li> <li>2. the level of insurance an efficient and prudent DNSP would obtain in respect of the event</li> <li>3. maintaining assets at a level expected of the industry</li> <li>4. the reasonable actual extent of the event, or series of related events, having regard to relevant factors including, but not limited to, enduring weather systems and earthquake aftershocks.</li> </ol>
Terrorism event	<p>An act (including, but not limited to, the use of force or violence or the threat of force or violence) of any person or group of persons (whether acting alone or on behalf of or in connection with any organisation or government), which from its nature or context is done for, or in connection with, political, religious, ideological, ethnic or similar purposes or reasons (including the intention to influence or intimidate any government and/or put the public, or any section of the public, in fear); and which materially increases the costs to Essential of providing direct control services. This includes (without limitation) actions that seriously interfere with, disrupt or destroy, an electronic system including a system used for, or by, an essential public utility.</p>
Major cyber event	<p>Major cyber event means any maliciously caused significant interruption to technology systems or assets occurring during the 2024–29 regulatory control period that materially increases the costs to Essential of providing direct control services.</p> <p>Note: in assessing a major cyber event pass through application, the AER will have regard to, among other things:</p> <ol style="list-style-type: none"> <li>1. Essential's efforts to prevent the event from occurring and mitigate its consequences</li> <li>2. the prevention and mitigation actions that an efficient and prudent DNSP would have implemented</li> <li>3. whether Essential has insurance against the event</li> <li>4. the level of insurance an efficient and prudent DNSP would obtain in respect of the event.</li> </ol>

Source: Essential Energy, *Pass Through Events Proposal*, January 2023, pp. 7–15.

## 15.3 Assessment approach

The NER set out how we must assess nominated pass through events, and how we must assess an application from a service provider to pass through changes in costs where an event occurs.<sup>5</sup>

Our assessment approach is guided by the National Electricity Objective (NEO)<sup>6</sup> and the Revenue and Pricing Principles (RPPs).<sup>7</sup> The RPPs include that the service provider should have a reasonable opportunity to recover at least the efficient costs of providing services and complying with regulatory obligations.<sup>8</sup> The NEO and the RPPs also reflect the importance of incentives to promote economic efficiency and balance the risks of under and over investment.

In the context of pass through events, we have particular regard to the impact on price, quality, reliability and security of supply that may arise as a result of any change in the efficient operation of, and ability and incentive of, a service provider to invest in its network. This is a similar approach to that taken by the Australian Energy Market Commission (AEMC) when considering pass through event rule changes.<sup>9</sup>

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

- a) whether the event proposed is an event covered by a category of pass through event specified in clause 6.6.1(a1)(1) to (4) (in the case of a distribution determination) or clause 6A.7.3(a1)(1) to (4) (in the case of a transmission determination);
- b) whether the nature or type of event can be clearly identified at the time the determination is made for the service provider;
- c) whether a prudent service provider could reasonably prevent an event of that nature or type from occurring or substantially mitigate the cost impact of such an event;
- d) whether the relevant service provider could insure against the event, having regard to:
  - 1) the availability (including the extent of availability in terms of liability limits) of insurance against the event on reasonable commercial terms;  
or

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

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

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

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

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

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

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

- 2) whether the event can be self-insured on the basis that:
  - i) it is possible to calculate the self-insurance premium; and
  - ii) the potential cost to the relevant service provider would not have a significant impact on the service provider's ability to provide network services; and
- e) any other matter the AER considers relevant and which the AER has notified network service providers is a nominated pass through event consideration.

The AEMC described the purpose of the nominated pass through event considerations as:

...to incorporate and reflect the essential components of a cost pass through regime in the NER. It was intended that in order for appropriate incentives to be maintained, any nominated pass through event should only be accepted when event avoidance, mitigation, commercial insurance and self-insurance are unavailable.<sup>12</sup>

...that a pass through event should only be accepted when it is the least inefficient option and event avoidance, mitigation, commercial insurance and self-insurance are found to be inappropriate. That is, it is included after ascertaining the most efficient allocation of risks between a service provider and end customers.<sup>13</sup>

This protects the incentive regime under the NER by limiting erosion of a service provider's incentives to use market-based mechanisms to mitigate the cost impacts that would arise. This promotes the efficient investment in, and efficient operation and use of, network services for the long-term interests of consumers with respect to price.<sup>14</sup>

As a matter of good regulatory practice, we also take into account the desirability of consistency in our approach to assessing nominated pass through events across our electricity determinations and gas access arrangements.<sup>15</sup>

## 15.4 Interrelationships

The pass through mechanism is not the only way service providers can manage their risks under a distribution or transmission determination. It is interrelated with other parts of this decision, in particular with the forecast operating and capital expenditure (opex and capex) and rate of return included in our revenue determination. We must

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

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

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

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



specify and take account of these interrelationships.<sup>16</sup> This requires us to balance the incentives in the various parts of our decision.

For systemic risks, service providers are compensated through the allowed rate of return. Service providers also face business-specific, or residual, risks. Service providers are compensated for the prudent and efficient management of these risks through the forecast opex and capex we include in our revenue determination for strategies such as:

- prevention (avoiding the risk)
- mitigation (reducing the probability and impact of the risk)
- insurance (transferring the risk to another party)
- self-insurance (putting aside funds to manage the likely costs associated with a risk event).

An efficient business will manage its risk by employing the most cost-effective combination of these strategies. In order to maintain appropriate incentives under our determinations, we only accept nominated pass through events where we are satisfied that event avoidance, mitigation, commercial insurance and self-insurance under approved forecasts of prudent and efficient opex and capex are either unavailable or inappropriate.<sup>17</sup>

In general, in respect of unforeseen costs that are relatively minor, a service provider should manage them by using up its existing expenditure allowance, or reprioritising or substituting its projects, to avoid seeking cost recovery through the pass through mechanisms.<sup>18</sup> This is reflected in the materiality threshold that applies to cost pass through applications.<sup>19</sup>

Cost pass through amounts approved in a regulatory control period are added to (or in the case of a negative pass through deducted from) forecast opex and capex for the purpose of calculating efficiency carryover amounts under the Efficiency Benefit Sharing Scheme and Capital Expenditure Sharing Scheme.<sup>20</sup>

Any capex that has already been recovered in a regulatory control period by way of a cost pass through cannot be recovered again in the roll-forward of the regulatory asset base for the next regulatory control period.<sup>21</sup>

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

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

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

<sup>19</sup> NER, Chapter 10: Glossary, definition of ‘materially’.

<sup>20</sup> AER, *Efficiency benefit sharing scheme*, November 2013, p. 7; AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013, p. 6.

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

## 15.5 Reasons for draft decision

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

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

- the proposed events are not covered by an existing category of pass through event
- the nature of the events are clearly identifiable at this time
- a prudent service provider could not reasonably prevent an event of that nature or type from occurring or substantially mitigate its cost impact and could not insure (or self-insure) against the events on reasonable commercial terms.

With regard to the latter point, while Essential could take steps to reduce its risk exposure to these events, expenditure beyond a certain level aimed at completely eliminating the risk is likely to be imprudent or inefficient. In that context, sharing the risk between Essential and its customers is appropriate and more likely to be in the long-term interests of consumers with respect to price.

While we accept the proposed terrorism, natural disaster, insurer's credit risk and insurance coverage cost pass through events, we do not accept the event definitions as proposed by Essential. This is because we either do not agree with the changes proposed by Essential and / or the proposed changes are minor in nature and are in most cases already captured in our current definitions as set out in our recent determinations.<sup>23</sup>

Essential initially proposed a range of changes to the definitions of the terrorism, natural disaster, insurer's credit risk and insurance coverage events without providing a rationale for the proposed changes.

We sought to clarify the changes proposed by Essential as part of our request for additional information process while signalling our preference to apply definitions which are consistent with our recent determinations.<sup>24</sup> In response, Essential:

- stated it slightly edited our definitions of insurance coverage and insurer credit risk events in an attempt to simplify them and put them into plain English. Essential also stated it would not object if we maintain our definitions as approved in our recent determinations for these events to maintain a greater level of consistency

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

<sup>23</sup> AER, *Final Decision – AusNet Services distribution determination 2021–26 – Attachment 15 – Pass through events*, April 2021, pp. 16–19; AER, *Final Decision – CitiPower distribution determination 2021–26 – Attachment 15 – Pass through events*, April 2021, pp. 14–16.

<sup>24</sup> AER, *AER's information request IR#044 – nominated cost pass through*, 24 July 2023.

with other DNSPs.<sup>25</sup> Consequently, we have maintained our current definitions for insurance coverage and insurer credit risk events in this draft decision as set out in Table 15.2.

- maintained its proposed changes for the natural disaster and terrorism events.<sup>26</sup>

Essential submitted that its proposed changes were discussed with and fully supported by its Stakeholder Collaboration Collective (SCC).<sup>27</sup>

We have not received any stakeholder submissions on the proposed cost pass through events.

Our considerations of the proposed definitions for the natural disaster and terrorism events are set out in the following sections.

### 15.5.1.1 Natural disaster event

Essential proposed to amend our definition of the natural disaster event by:<sup>28</sup>

- explicitly adding a reference to 'series of related natural disaster events'
- including two new factors we are to take into account when considering a natural disaster cost pass through application.

We consider each of these points in the following sections.

### 15.5.1.2 Explicit reference to 'series of related natural disaster events'

Essential proposed to include a reference to 'series of related natural disaster events' to reflect that an 'event' can relate to an isolated event and / or a series of related events. It relied on its experience in recent years, including a scenario where multiple events occur in the same area within a short timeframe which may compound each other, making the overall situation worse.<sup>29</sup> Essential referred to the example of the floods in northern New South Wales (NSW) in 2022, and the bushfires of 2019–20 across the state.<sup>30</sup>

While we agree that the scenario presented by Essential is likely and did occur in both NSW and Victoria, we consider that our current definition already effectively captures the issues Essential's proposed amendments are seeking to address. Under our

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<sup>25</sup> Essential Energy, *Response to AER's information request IR#044 – nominated cost pass through*, 1 August 2023.

<sup>26</sup> Essential Energy, *Response to AER's information request IR#044 – nominated cost pass through*, 1 August 2023.

<sup>27</sup> Essential Energy, *Response to AER's information request IR#044 – nominated cost pass through*, 1 August 2023.

<sup>28</sup> Essential Energy, *8.07 Pass Through Events Proposal*, January 2023, pp. 9–11; Essential Energy, *Response to AER's information request IR#044 – nominated cost pass through*, 1 August 2023.

<sup>29</sup> Essential Energy, *Response to AER's information request IR#044 – nominated cost pass through*, 1 August 2023.

<sup>30</sup> Essential Energy, *Response to AER's information request IR#044 – nominated cost pass through*, 1 August 2023.

current definition for natural disaster event, network service providers already can make a cost pass through application following a natural disaster event which involves several individual but related events. For example, some of our recent determinations for natural disaster cost pass through applications relating to bushfires included the assessment of cases where the businesses (including Essential) proposed that multiple bushfires across their network over a specific period be considered as a single natural disaster event.

AusNet Services, Endeavour Energy, Essential, and Transgrid submitted natural disaster cost pass through applications for the 2019–20 bushfires where they each proposed a range of multiple bushfires be considered as a single natural disaster event.<sup>31</sup> We assessed these applications, agreeing with the businesses in some cases and disagreeing with others based on the information provided. This demonstrates that our current definition is sufficiently broad and captures the issues Essential's definition is seeking to address. Our determinations are publicly available.<sup>32</sup>

For the above reasons we do not accept Essential's amendments. In this draft decision, we maintain our current definition for natural disaster as set out in Table 15.2.

### 15.5.1.3 Inclusion of new factors

Our current definition for natural disaster event includes some factors we are to take into account when assessing a cost pass through application for natural disasters. However, Essential proposed to include two new factors in addition to those that are already reflected in our current definition:<sup>33</sup>

- 'Whether a relevant government authority has made a declaration that a natural disaster has occurred'
- 'The reasonable actual extent of the event, or series of related events, having regard to relevant factors including, but not limited to, enduring weather systems and earthquake aftershocks'.

Essential did not provide reasons for these proposed inclusions.<sup>34</sup>

We do not consider the proposed amendments are necessary given that our current definition for natural disaster is sufficiently broad to allow us to have regard to such

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<sup>31</sup> Essential Energy, *Cost Pass Through Application*, 28 September 2021, p. 5; Transgrid, *Cost pass through application – 2019–20 bushfire season*, 13 November 2020; AusNet Services, *2020 bushfire event cost pass through application*, 27 May 2020, pp. 9-14; Endeavour Energy, *2019-20 bushfire disaster event cost pass through application*, 31 August 2020, pp. 7-9.

<sup>32</sup> AER, *AER determination – AusNet 2019–20 bushfire cost pass through*, November 2020, p. 17; AER, *AER determination – Endeavour Energy bushfire pass through*, February 2021, p. 17; AER, *AER determination – Essential Energy 2019–20 bushfire cost pass through*, March 2022, pp. 8–11; AER, *AER determination – TransGrid 2019-20 bushfire cost pass through*, May 2021, pp. 4–22.

<sup>33</sup> Essential Energy, *Response to AER's information request IR#044 - nominated cost pass through*, 1 August 2023; Essential Energy, *8.07 Pass Through Events Proposal*, January 2023, pp. 9–11.

<sup>34</sup> Essential Energy, *Response to AER's information request IR#044 - nominated cost pass through*, 1 August 2023; Essential Energy, *Regulatory proposal 2024–29 - Attachment 8.07 Pass through events proposal*, January 2023, pp. 9–11.

factors if relevant in the specific circumstances. For example, it is not necessary to include an exhaustive list of factors because the definition includes a reference to 'among other things' in respect of these factors. This is reflected by the fact that we discussed these factors in our recent determinations for natural disaster cost pass through despite our current definition not mentioning them explicitly.<sup>35</sup>

For the above reasons we do not accept Essential's proposed amendments. Instead, we have maintained our current definition as set out in Table 15.2.

#### 15.5.1.4 Terrorism event

Essential proposed to amend the definition of the terrorism event to specifically include cyber-attack actions.<sup>36</sup>

Our draft decision is to not accept the proposed change to the terrorism event. This is consistent with our recent determinations on pass through events (e.g., Power and Water Corporation's 2024–29 draft determination, SA Power Networks' 2020–25 regulatory determination, Citipower's 2021–26 determination).<sup>37</sup>

Our draft decision does not mean Essential would not be able to seek a cost pass through for cyber-attacks in any event. We noted in our previous determinations for other distributors that the nominated 'terrorism' pass through event could include cyber-terrorism.<sup>38</sup> Accordingly, if a cyber-attack has the characteristics of an act of terrorism, then Essential could apply to have those costs passed through where the other elements of the definition are satisfied. However, we do not believe it is necessary to include a description of cyber-terrorism in the definition.

In our recent determination for ElectraNet (2023–28), we also noted that the insurance coverage event already allows for recovery of cyber-attack costs where the other elements of that definition are satisfied.<sup>39</sup>

For the above reasons we have maintained our current definition of a terrorism event. This is further elaborated in the following section 15.5.2.

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<sup>35</sup> AER, *AER Determination – Essential Energy 2019–20 bushfire cost pass through*, March 2022, pp. 8–11.

<sup>36</sup> Essential Energy, *Response to AER's information request IR#044 - nominated cost pass through*, 1 August 2023.

<sup>37</sup> AER, *Draft Decision, SA Power Networks Distribution determination 2020–25, Attachment 14 Pass through events*, October 2019, p. 15; AER, *Draft decision – CitiPower 2021–26 - Attachment 15: Pass through events*, April 2021, pp. 17–19; AER, *Final decision – ElectraNet transmission determination 2023–28 - Attachment 13 – Cost pass through events*, April 2023, p. 8; SA Power Networks and Citipower had proposed a standalone cyber-attack event, ElectraNet proposed to amend the definition of 'costs' in the insurance coverage definition to explicitly reflect costs related to a cyber-attack.

<sup>38</sup> AER, *Final Decision – CitiPower distribution determination 2021–26 – Attachment 15 – Pass through events*, April 2021, pp. 19–20; AER, *Essential Energy 2019–24 Draft decision – Attachment 14 – Pass through events*, November 2018, pp.13–14.

<sup>39</sup> AER, *ElectraNet 2023–28 – Final decision – Attachment 13 – Cost pass through events*, April 2023, p. 8.

## 15.5.2 Major cyber event

Essential proposed a major cyber event in addition to its proposed amendments to the terrorism event, which aimed to include cyber-attack actions. In proposing this new event, Essential considered it is impossible to completely protect itself against determined and sophisticated cyberattacks no matter how much it spends on cybersecurity and how diligent it is in protecting its assets, systems and data.<sup>40</sup> Essential also considered that including a major cyber event represents the most prudent and efficient means for managing a risk of this nature over the 2024–29 regulatory period.

Our draft decision is to not include the major cyber event proposed by Essential. We accept that the occurrence of major cyber events, as defined, cannot be completely ruled out. However, one of the key factors under the NER nominated cost pass through considerations is 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.<sup>41</sup> We consider it is appropriate for network service providers to be incentivised to prevent or otherwise mitigate the risk of major cyber events occurring, and also to mitigate the extent of damage that may be caused by them and any impact on the provision of direct control services.

If we were to accept this pass through event, the incentive on Essential and other service providers to proactively manage cyber security risks and adopt best practices would likely be significantly reduced. Although Essential has no control on what third parties do, it controls the cyber security and protection of its ICT systems and assets, which affects its susceptibility to cyber-attacks and the likelihood of a major cyber event. Essential has a regulatory obligation to maintain the security of supply of electricity, and an incentive to ensure the security of its network systems is sufficiently robust and resilient to withstand cyber-threats such that a major interruption to its technology systems and assets would not occur. We consider Essential can substantially mitigate the risk and cost impact of this type of event in a forward-looking manner, by ensuring appropriate cyber-security protections are in place and having appropriate contingency precautions, and insurance coverage.

Our recent decisions for other distributors to not accept a major cyber event are because we consider cyber security risk is one of the key business risks an energy network service provider faces.<sup>42</sup> This risk should be largely borne by the network service provider, who is best placed to manage it, rather than consumers.<sup>43</sup> We consider accepting the proposed broadly defined major cyber event is likely to have the

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<sup>40</sup> Essential Energy, *8.07 Pass Through Events Proposal*, January 2023, pp. 9–11.

<sup>41</sup> NER, Chapter 10, Nominated pass through event considerations (c).

<sup>42</sup> AER, *draft decision – CitiPower distribution determination 2021–2026 – Attachment 15 – Pass through events*, September 2020, pp.17–19.

<sup>43</sup> AER, *draft decision – CitiPower distribution determination 2021–2026 – Attachment 15 – Pass through events*, September 2020, pp.17–19.

effect of passing Essential’s cyber-security risk to consumers and erode its incentives to manage this risk efficiently and prudently.

Our recent decisions also emphasised that all Australian utility providers operate national critical infrastructure and are subject to stringent cyber security compliance requirements.<sup>44</sup> We expect Essential would have appropriate safeguards or contingency plans to substantially mitigate the risks and cost impacts of major cyber-attacks. Supporting this, Essential's forecasts of operating and capital expenditure provide Essential significant resources in relation to cyber security and information and communications technology activities. This expenditure is intended for Essential to strengthen its capability to proactively identify, protect, detect, respond to and recover from cyber security threats.

For the above reasons, our draft decision is not to accept the nominated major cyber event.

Table 15.2 summarises the nominated pass through events accepted by us in the draft decision.

**Table 15.2 AER pass through event definitions**

Pass through event	Draft decision definition
Insurance coverage event	<p>An insurance coverage event occurs if:</p> <ol style="list-style-type: none"> <li>1. Essential:               <ol style="list-style-type: none"> <li>a) makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy or set of insurance policies; or</li> <li>b) would have been able to make a claim or claims under a relevant insurance policy or set of insurance policies but for changed circumstances; and</li> </ol> </li> <li>2. Essential incurs costs:               <ol style="list-style-type: none"> <li>a) beyond a relevant policy limit for that policy or set of insurance policies; or</li> <li>b) that are unrecoverable under that policy or set of insurance policies due to changed circumstances; and</li> </ol> </li> <li>3. The costs referred to in paragraph 2 above materially increase the costs to Essential in providing direct control services.</li> </ol> <p>For the purposes of this insurance coverage event:</p> <ul style="list-style-type: none"> <li>• 'changed circumstances' means movements in the relevant insurance liability market that are beyond the control of Essential, where those movements mean that it is no longer possible for Essential to take out an insurance policy or set of insurance</li> </ul>

<sup>44</sup> AER, *draft decision – CitiPower distribution determination 2021–2026 – Attachment 15 – Pass through events*, September 2020, pp.17–19.

Pass through event	Draft decision definition
	<p>policies at all or on reasonable commercial terms that include some or all of the costs referred to in paragraph 2 above within the scope of that insurance policy or set of insurance policies.</p> <ul style="list-style-type: none"> <li>• 'costs' means the costs that would have been recovered under the insurance policy or set of insurance policies had: <ul style="list-style-type: none"> <li>– the limit not been exhausted; or</li> <li>– those costs not been unrecoverable due to changed circumstances.</li> </ul> </li> <li>• 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 Essential was regulated; and</li> <li>• Essential 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 Essential in relation to any aspect of Essential's network or business; and</li> <li>• Essential 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 Essential in relation to any aspect of Essential's network or business.</li> </ul> <p>Note for the avoidance of doubt, in assessing an insurance coverage event through application under rule 6.6.1(j), the AER will have regard to:</p> <ul style="list-style-type: none"> <li>i) the relevant insurance policy or set of insurance policies for the event</li> <li>ii) the level of insurance that an efficient and prudent DNSP would obtain, or would have sought to obtain, in respect of the event</li> <li>iii) any information provided by Essential to the AER about Essential's actions and processes; and</li> <li>iv) any guidance published by the AER on matters the AER will likely have regard to in assessing any insurance coverage event that occurs.</li> </ul>
Insurer's credit risk event	<p>An insurer credit risk event occurs if an insurer of Essential becomes insolvent, and as a result, in respect of an existing or potential claim for a risk that was insured by the insolvent insurer, Essential:</p> <ul style="list-style-type: none"> <li>a) is subject to a higher or lower claim limit or a higher or lower deductible than would have otherwise applied under the insolvent insurer's policy; or</li> <li>b) Incurs additional costs associated with funding an insurance claim, which would otherwise have been covered by the insolvent insurer.</li> </ul>



Pass through event	Draft decision definition
	<p>Note: in assessing an insurer credit risk event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> <li>i) Essential attempts to mitigate and prevent the event from occurring by reviewing and considering the insurer's track record, size, credit rating and reputation, and</li> <li>ii) in the event that a claim would have been covered by the insolvent insurer's policy, whether Essential had reasonable opportunity to insure the risk with a different provider.</li> </ul>
Natural disaster event	<p>Natural disaster event means any natural disaster including but not limited to cyclone, fire, flood or earthquake that occurs during the 2024–29 regulatory control period that increases the costs to Essential in providing direct control services, provided the cyclone, fire, flood, earthquake or other event was:</p> <ul style="list-style-type: none"> <li>a) a consequence of an act or omission that was necessary for the service provider to comply with a regulatory obligation or requirement or with an applicable regulatory instrument; or</li> <li>b) not a consequence of any other act or omission of the service provider.</li> </ul> <p>Note: In assessing a natural disaster event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> <li>i) whether Essential has insurance against the event;</li> <li>ii) the level of insurance that an efficient and prudent NSP would obtain in respect of the event.</li> </ul>
Terrorism event	<p>Terrorism event means an act (including, but not limited to, the use of force or violence or the threat of force or violence) of any person or group of persons (whether acting alone or on behalf of or in connection with any organisation or government), which:</p> <ol style="list-style-type: none"> <li>1. from its nature or context is done for, or in connection with, political, religious, ideological, ethnic or similar purposes or reasons (including the intention to influence or intimidate any government and/or put the public, or any section of the public, in fear); and</li> <li>2. changes the costs to Essential in providing direct control services.</li> </ol> <p>Note: In assessing a terrorism event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> <li>i) whether Essential has insurance against the event;</li> <li>ii) the level of insurance that an efficient and prudent NSP would obtain in respect of the event; and</li> <li>iii) whether a declaration has been made by a relevant government authority that a terrorism event has occurred.</li> </ul>

Source: AER analysis

## Shortened forms

Term	Definition
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
Capex	Capital expenditure
DNSP	Distribution network service provider
NEL	National electricity law
NEM	National electricity market
NEO	National electricity objective
NER	National electricity rules
NSP	Network service provider
Opex	Operating expenditure
RPP	Revenue and pricing principles

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