



DRAFT DECISION

AusNet Services Transmission Determination 2022 to 2027

Attachment 13 Pass through events

June 2021

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AER reference: 65242

Note

This attachment forms part of the AER's draft decision on AusNet Services' 2022–27 transmission determination. It should be read with all other parts of the draft decision.

The draft decision includes the following attachments:

Overview

Attachment 1 – Maximum allowed revenue

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 11 – Demand management innovation allowance mechanism

Attachment 12 – Pricing methodology

Attachment 13 – Pass through events

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13 Cost pass through events

During the regulatory control period AusNet Services can apply to pass through to its customers, in the form of higher or lower network charges, certain material changes in its costs caused by pre-defined exogenous events. These events are called cost pass through events. 'Positive' pass throughs allow AusNet Services to recover the efficient costs incurred as a result of events that could not be forecast as part of its regulatory proposal and which would otherwise have a significant financial effect on AusNet Services' ability to invest in and operate its networks.¹

The National Electricity Rules (NER) prescribe the following pass through events for all transmission determinations:²

- a regulatory change event
- a service standard event
- a tax change event
- an insurance event.

In addition to these prescribed events, other pass through events may be 'nominated' by a service provider for a regulatory control period.³ This attachment sets out our draft decision on the nominated pass through events to apply to AusNet Services for the 2022–27 regulatory control period.

13.1 Draft decision

Our draft decision, pursuant to clause 6A.14.1(9) of the NER, is to accept some of AusNet Services' nominated pass through events as they apply to its transmission network. Accordingly we propose that the following are pass through events for the purpose of clause 6A.7.3(a1)(5) of the NER for the 2022–27 regulatory control period:

- insurance coverage event
- terrorism event (but not the amendment proposed by AusNet Services)
- natural disaster event
- insurer credit risk event
- Victorian Energy Minister's power to direct augmentation event.

These events are defined in Table 13.2. The reasons for our decisions are set out in section 13.4. We have accepted a minor amendment to the insurance coverage event and made minor amendments to the definitions for the natural disaster and terrorism events. Our reasons for these decisions are set out in section 13.4.2.

¹ AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 2.

² NER, cl. 6A.7.3(a1)(1)–(4).

³ NER, cl. 6A.7.3(a1)(5).

We acknowledge there is some overlap between the prescribed insurance event, nominated insurance coverage pass through event and insurer credit risk event. While one of the nominated pass through considerations is whether the event proposed is covered by a prescribed event in the NER,⁴ we consider there is merit in including the insurance coverage and insurer credit risk nominated pass through events. This approach provides consistency across our recent resets and we see value in providing greater clarity to the industry on the operation of these events by including the same level of detail in their definitions as for the Victorian, South Australia and Queensland distributors.⁵

Our draft decision is to not accept the proposed contamination remediation event and the major cyber event. Our reasons for these decisions are set out in sections 13.4.3 and 13.4.4.

AusNet Services also indicated that it is conducting a full costing exercise to determine the appropriate network support costs that are likely to be required in the upcoming regulatory control period. It considered the network support pass-through mechanism under clause 6A.7.2 of the NER may be the most appropriate mechanism for recovering these costs,⁶ although its position was not sufficiently clarified in subsequent discussions with us. Given that the details on this are still to be clarified, we have deferred forming a view on this matter.

⁴ See NER, Chapter 10 – Glossary, nominated pass through event considerations definition.

⁵ AER, *Final Decision, SA Power Networks Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 13–14; AER, *Final Decision, Ergon Energy Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 9–10; AER, *Final Decision, Energex Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 9–10; AER, *Final Decision, AusNet Services Distribution Determination 2021–26, Attachment 15 Pass through events*, April 2021, pp. 9–10.

⁶ AusNet Services, *Revenue Proposal 2023–27*, 29 October 2020, p. 240.

13.2 AusNet Services' proposal

AusNet Services proposed seven nominated pass through events as set out in Table 13.1.

Table 13.1 AusNet Services' nominated pass through events

Proposed event	Proposed definition
Insurance coverage event	<p>A. An Insurance Coverage event occurs if AusNet Services:</p> <ul style="list-style-type: none"> 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, <p>and AusNet Services:</p> <ul style="list-style-type: none"> c. is required to pay a deductible in respect of a claim or claims; or d. incurs costs beyond a policy limit for the relevant insurance policy or set of insurance policies; or e. incurs costs that are unrecoverable under the relevant insurance policy or set of insurance policies (whether wholly or in part) due to changed circumstances, <p>and the costs referred to in paragraphs (c)-(e) above, either separately or in aggregate, increase the cost to AusNet Services of providing prescribed transmission services.</p> <p>B. For the purposes of this Insurance Coverage event:</p> <ul style="list-style-type: none"> a. 'changed circumstances' means movements in the relevant insurance liability market since the acquisition of the insurance policy or set of insurance policies that applied during the majority of AusNet Services' base year and that are beyond the reasonable control of AusNet Services, where those movements result in it no longer being prudent or efficient for AusNet Services to take out with a reputable insurer: <ul style="list-style-type: none"> 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), <p>either at all or on commercial terms reasonable to AusNet Services.</p> b. 'costs' include: <ul style="list-style-type: none"> i. the deductible payable under a relevant insurance policy or set of insurance policies; ii. the amount or amounts that would have been recovered under the relevant insurance policy or set of insurance policies: <ul style="list-style-type: none"> 1. had the limit not been exhausted; or 2. but for the changed circumstances. c. 'reputable insurer' means an insurer with a current financial security rating of A or better by Standard and Poor's (or the equivalent rating with another reputable rating agency). d. '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 AusNet Services was regulated. e. AusNet Services 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 AusNet Services in relation to any aspect of AusNet Services' network or business. f. AusNet Services 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 AusNet Services in relation to any aspect of AusNet Services' network or business. <p>C. For the avoidance of doubt, in assessing an Insurance Coverage event pass through application under clause 6A.7.3(j), the AER will have regard to:</p> <ul style="list-style-type: none"> a. the relevant insurance policy or set of insurance policies for the event;

Proposed event	Proposed definition
	<ul style="list-style-type: none"> b. the level of insurance that an efficient and prudent TNSP would obtain, or would have sought to obtain, in respect of the event; c. any guidance published by the AER on matters the AER will likely have regard to in assessing an Insurance Coverage event; and d. any information provided by AusNet Services to the AER about AusNet Services' actions and processes.
Terrorism event	<ul style="list-style-type: none"> A. A Terrorism event means an act (including, but not limited to, the use of force or violence or the threat of force or violence) by any person or any group of persons (whether acting alone or on behalf of or in connection with any organisation or government), which: <ul style="list-style-type: none"> a. from its nature or context is done or appears to be 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. increases the cost to AusNet Services in providing prescribed transmission services. B. In assessing a Terrorism event pass through application, the AER will have regard to, amongst other things: <ul style="list-style-type: none"> a. whether AusNet Services has insurance against the event; b. the level of insurance that an efficient and prudent TNSP would obtain in respect of the event; and c. whether a declaration has been made by a relevant government authority that an act of terrorism has occurred.
Natural disaster event	<ul style="list-style-type: none"> A. Natural Disaster Event means a natural disaster including but not limited to fire, flood or earthquake that occurs during the 2023-27 regulatory control period and that increases the costs to AusNet Services of providing prescribed transmission services, provided the fire, flood or other event is: <ul style="list-style-type: none"> a. not a consequence of the acts or omissions of AusNet Services; or b. a consequence of an act or omission that was necessary for AusNet Services to comply with a regulatory obligation or requirement or an applicable regulatory instrument. B. In assessing a Natural Disaster event pass through application, the AER will have regard to, amongst other things: <ul style="list-style-type: none"> a. the extent to which AusNet Services holds insurance against the event; and b. the level of insurance that a prudent and efficient TNSP would obtain in respect of the event.
Insurer credit risk event	<ul style="list-style-type: none"> A. An Insurer's Credit Risk event occurs if a nominated insurer of AusNet Services becomes insolvent, and, as a result, in respect of an existing, or potential, claim for a risk that was insured by the insolvent insurer, AusNet Services: <ul style="list-style-type: none"> 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. B. In assessing an Insurer's Credit Risk event pass through application, the AER will have regard to, amongst other things: <ul style="list-style-type: none"> a. AusNet Services' attempts to mitigate and prevent the event from occurring by reviewing and considering the insurer's track record, size, credit rating and reputation; and b. in the event that a claim would have been made after the insurance provider became insolvent, whether AusNet Services had reasonable opportunity to insure the risk with a different provider.

Proposed event	Proposed definition
Contamination remediation event	<ul style="list-style-type: none"> a) A Contamination Remediation event occurs if: <ul style="list-style-type: none"> b) AusNet Services is required to perform a program of remediation or similar works in order to comply with an obligation imposed by: <ul style="list-style-type: none"> c) an amendment made to the Environmental Protection Act 2017 (Vic) by the Environment Protection Amendment Act 2018 (Vic); or d) any instrument made or issued under or for the purposes of the 2017 Act (as amended); and e) the cost of performing the program of works in order to comply with the obligation or obligations referred to in paragraph (a) were not included in the capital or operating expenditure forecasts proposed by AusNet Services and approved by the AER for the 2023-27 regulatory control period; and f) the cost of complying with the obligation or obligations referred to in paragraph (a) increases the cost to AusNet Services of providing prescribed transmission services.
Major cyber event	<ul style="list-style-type: none"> A. A Major Cyber event is any significant and deliberate interference with AusNet Services' technology systems or assets (including, but not limited to, the introduction of malicious or harmful software, code or viruses to computer systems or networks, or to data or communication systems) carried out, directed or otherwise caused by an act of a third party that: <ul style="list-style-type: none"> a. falls into no other category of pass through event; and b. increases the costs to AusNet Services of providing prescribed transmission services. B. In assessing a Major Cyber Event pass through application, the AER will have regard to, amongst other things: <ul style="list-style-type: none"> a. the steps AusNet Services took to prevent the event from occurring and to mitigate its consequences; and b. the level and scope of any insurance AusNet Services holds in respect of a Major Cyber Event.
Victorian Energy Minister's power to direct augmentation event	<ul style="list-style-type: none"> A. A Ministerial Transmission Augmentation Order event occurs if each of the following conditions are satisfied: <ul style="list-style-type: none"> a. the Minister makes an order under section 16Y(1) of the National Electricity (Victoria) Act 2005 (Vic) (Order); b. complying with the Order, or assisting AEMO or a third party to comply with its obligations under the Order, increases the cost to AusNet Services of providing prescribed transmission services.

Source: AusNet Services, *Revenue Proposal 2023–27*, 29 October 2020, pp. 227–240.

13.3 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.

Our assessment approach is guided by the National Electricity Objective (NEO) and the Revenue and Pricing Principles. These provide, in part, that the service provider should have a reasonable opportunity to recover at least the efficient costs of providing services and complying with regulatory obligations.⁷ They also reflect the importance of

⁷ NEL, s. 7A(2).

incentives to promote economic efficiency⁸ and balance the risks of under and over investment.⁹ 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 AEMC when considering pass through event rule changes.¹⁰

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

- 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);
- whether the nature or type of event can be clearly identified at the time the determination is made for the service provider;
- whether a prudent service provider could reasonably prevent an event of that nature or type from occurring or substantially mitigate the cost impact of such an event;
- whether the relevant service provider could insure against the event, having regard to:
 - the availability (including the extent of availability in terms of liability limits) of insurance against the event on reasonable commercial terms; or
 - whether the event can be self-insured on the basis that:
 - it is possible to calculate the self-insurance premium; and
 - the potential cost to the relevant service provider would not have a significant impact on the service provider's ability to provide network services; and.
- any other matter the AER considers relevant and which the AER has notified a 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

⁸ NEL, s. 7A(3).

⁹ NEL, s. 7A(6).

¹⁰ NEL, s. 7; AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 6.

¹¹ NER, cl. 6A.6.9(b); NER, Chapter 10, definition of nominated pass through event considerations.

are unavailable. That is, a cost pass through event is the least efficient option for managing the risk of unforeseen events.¹²

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.¹³

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.¹⁴ 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.¹⁵

As a matter of good regulatory practice, we also take into account the desirability of consistency in our approach to assessing nominated cost pass through events across our electricity determinations and gas access arrangements.¹⁶

13.3.1 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 expenditure (opex), capital expenditure (capex) and rate of return included in our revenue determination. These interrelationships require 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).

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

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

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

¹⁵ AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 8.

¹⁶ AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 18.

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.¹⁷

In general, in respect of smaller projects a service provider should be using up its existing expenditure allowance, or reprioritising or substituting its projects, to avoid seeking cost recovery through the pass through mechanisms.¹⁸ This is reflected in the materiality threshold that applies to cost pass throughs applications.¹⁹

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 EBSS and CESS.²⁰

Cost pass through amounts that have already been recovered in a regulatory period cannot be recovered again in the roll-forward of the regulatory asset base (RAB) for the next regulatory period.²¹

13.4 Reasons for draft decision

13.4.1 Insurance coverage event

Our draft decision is to include an insurance coverage event. We have accepted one of the amendments proposed by AusNet Services.

AusNet Services proposed a number of definitional amendments to the insurance coverage event,²² which are essentially the same as the Victorian electricity distributors also proposed as a part of the process for the 2021–26 determinations (see below).²³ We understand the amendments proposed by the Victorian electricity distributors were intended to clarify the operation of the insurance coverage event.

When we replaced the insurance cap event with the insurance coverage event in recent decisions,²⁴ we inserted three key changes to the definition:

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

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

¹⁹ NER, Chapter 10: Glossary, definition of 'materially'.

²⁰ AER, *Efficiency Benefit Sharing Scheme for Electricity Network Service Providers*, November 2013, p. 9; AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013, p. 18.

²¹ NER, cl. 6A.2.1(f)(1)(ii).

²² AusNet Services, *Revenue Proposal 2023–27*, 29 October 2020, pp. 228–230.

²³ Powercor, *2021–26 Revised Regulatory Proposal*, December 2020, p. 12; CitiPower, *2021–26 Revised Regulatory Proposal*, December 2020, p. 12; United Energy, *2021–26 Revised Regulatory Proposal*, December 2020, p. 12; Jemena, *2021–26 Revised Regulatory Proposal*, December 2020, pp. 1–3; AusNet Services, *2021–26 Revised Regulatory Proposal*, December 2020, pp. 154–155.

²⁴ AER, *Final Decision, SA Power Networks Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 13–14; AER, *Final Decision, Ergon Energy Distribution Determination 2020–25*,

- "changed circumstances" means movements in the relevant insurance liability market that are beyond the control of the network business, where those movements mean that it is no longer possible for the network business to take out an insurance policy or set of insurance policies at all or on reasonable commercial terms that include some or all of the costs referred to in the definition within the scope of that insurance policy or set of insurance policies
- "costs" means the costs that would have been recovered under the insurance policy or set of insurance policies had:
 1. the limit not been exhausted; or
 2. those costs not been unrecoverable due to changed circumstances.
- "a relevant insurance policy or set of insurance policies" means an insurance policy or set of insurance policies held during the regulatory control period or a previous regulatory control period in which a network business was regulated.

These key changes recognised the possibility of future coverage gaps (negative impacts on deductible schedules or reinstatement rights due to movements in the insurance liability market that are beyond the control of the network business) and that network businesses often have multiple insurance policies. At the same time, we sought to preserve appropriate pass through event incentives under a normal operating environment.

We have applied the insurance coverage definition in this draft decision to other service providers in recent decisions.²⁵ We consider it would be preferable to maintain a consistent definition across network businesses rather than update the definition with the minor amendments proposed by AusNet Services. The amendments proposed by AusNet Services that we have not accepted include:²⁶

- clarifying that AusNet Services is required to pay a deductible in respect of a claim or claims and such a payment might not be covered under the event
- clarifying that unrecoverable costs may include such costs "whether wholly or in part"
- clarifying that costs may be incurred "either separately or in aggregate"
- providing the definition for the base year

Attachment 14 Pass through events, June 2020, pp. 9–10; AER, *Final Decision, Energex Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 9–10.

²⁵ AER, *Final Decision, SA Power Networks Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 13–14; AER, *Final Decision, Ergon Energy Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 9–10; AER, *Final Decision, Energex Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 9–10.

²⁶ AusNet Services, *Revenue Proposal 2023–27*, 29 October 2020, pp. 228–229.

- clarifying that "changed circumstances" includes movements in the relevant insurance liability market "since the acquisition of the insurance policy or set of insurance policies that applied during the majority of the base year."

A further amendment proposed by AusNet Services is that "changed circumstances" should mean movements in the relevant insurance liability market that result in it no longer being possible for AusNet Services to take out a relevant insurance policy with a "reputable insurer".²⁷ We consider that the decision for AusNet Services to seek appropriate insurance cover on reasonable commercial terms is solely in the domain of the business, and we expect that AusNet Services will safeguard that business decision. We do not consider it necessary to prescribe the insurers who AusNet Services may seek coverage from. We have not accepted this proposed amendment.

We accept the amendment AusNet Services proposed to include "any guidance published by the AER on matters the AER will likely have regard to in assessing any insurance coverage event that occurs" as a matter that the AER will have regard to in assessing an insurance coverage pass through event application.²⁸ This aligns with our work to release a final guidance note on the insurance coverage pass through event following further consultation with stakeholders in July 2021.²⁹

13.4.2 Terrorism, natural disaster, insurer credit risk event

We have included these events in our draft decision. We did not accept the amendment proposed by AusNet Services on the terrorism event to maintain consistency with our recent decisions.³⁰ However, we have made minor amendments to the definitions of natural disaster and terrorism events to reflect the symmetry between positive and negative cost pass through events reflected in the NER and add clarity.³¹ Specifically, in these two event definitions we have replaced "increases the costs" with "changes the costs". We also adopted an additional explicit reference to "cyclone" and "earthquake" in the definition of natural disaster event for consistency with recent determinations.³² The amended definitions are set out in Table 13.2.

13.4.3 Contamination remediation event

Our draft decision is to not include the nominated contamination remediation event proposed by AusNet Services.

AusNet Services proposed to include a nominated pass through event due to the commencement on 1 July 2021 of the *Environment Protection Act 2017* (as amended

²⁷ AusNet Services, *Revenue Proposal 2023–27*, 29 October 2020, pp. 229.

²⁸ AusNet Services, *Revenue Proposal 2023–27*, 29 October 2020, pp. 229.

²⁹ See AER, *Draft Guidance Note – Guidance Note on insurance coverage pass through event*, February 2021, p. 4.

³⁰ AER, *Final decision, AusNet Services Distribution Determination 2021–26, Attachment 15 Pass through events*, April 2021, p. 11; AER, *Final decision, Powercor distribution determination 2019–24, Attachment 15 Pass through events*, April 2021, p. 11.

³¹ NER, cl. 6.6.1 (a)-(b).

³² AER, *Final decision, AusNet Services Distribution Determination 2021–26, Attachment 15 Pass through events*, April 2021, p. 11; AER, *Final decision, Powercor distribution determination 2019–24, Attachment 15 Pass through events*, April 2021, p. 11.

by the *Environment Protection Amendment Act 2018 (VIC)* (the amended *Environment Protection Act 2017*), replacing the existing *Environment Protection Act 1970 (VIC)*.³³ It noted that the *Environment Protection Act 2017 (VIC)* will maintain a range of existing obligations and introduce new obligations – these include a general environmental duty, a duty to manage contaminated land and a duty to notify of contaminated land. AusNet Services also proposed an opex step change of \$3.2 million (\$2021–22) to establish a new proactive testing and monitoring regime to meet these new obligations.³⁴

AusNet Services did not consider the obligation to manage contaminated land can be treated as a regulatory change event. This is because the trigger for the event will be the discovery of the contaminated land (following the proactive testing and monitoring) not the making or amendment of a regulatory obligation or requirement due to the commencement of the amended *Environment Protection Act 2017 (VIC)*.³⁵ It considered the risks associated with the uncertainty about discovering contaminated land, and the cost of managing that land, which may include remediation and could be significant, would be most appropriately addressed by a nominated pass-through event.

AusNet Services also argued that because there is a 90 business day limit for lodging a pass through application under clause 6A.7.3(c) of the NER, it is possible that the time between the trigger event for a regulatory change event (i.e. the creation of the new regulatory obligation or requirement) and its discovery of a previously unidentified contaminated site that requires remediation, may exceed 90 business days. AusNet Services considered that this may introduce a gap that may preclude it from being able to recover its efficient costs of providing prescribed transmission services.³⁶

We consider that the proposed contamination remediation event meets some of the considerations that we need to take into account when deciding whether to accept or not accept a nominated pass through event (see section 13.3). It appears that the nature or type of event can be clearly identified as there is some likelihood that following testing and monitoring, land contamination remediation may be required. Further, we consider that the event is unlikely to be covered by the prescribed pass through events specified in the NER, particularly the regulatory change event. This is because:

- the amended *Environment Protection Act 2017 (VIC)* comes into effect on 1 July 2021, which is prior to and outside of AusNet Services' next regulatory control period
- we understand from the Environment Protection Authority (EPA) that under the amended *Environment Protection Act 2017 (VIC)* while there may be increases in testing requirements, there is minimal change to the environmental benchmarks

³³ AusNet Services, *Revenue Proposal 2023–27*, 29 October 2020, p. 233.

³⁴ Further details of our assessment of this step change are in Attachment 6 of this draft decision, section 6.4.3.3.

³⁵ AusNet Services, *Revenue Proposal 2023–27*, 29 October 2020, p. 234.

³⁶ AusNet Services, *Information request 14*, April 2021.

and obligations relating to noise, air, water and soil quality that would have a material impact on the businesses³⁷

- there is some merit in the reasons provided by AusNet Services that the nominated pass through event may not fall within the scope of the prescribed regulatory change event.

However, it is not clear to us whether AusNet Services could reasonably prevent the event (contamination remediation) from occurring or substantially mitigate the cost of such an event. We understand that the obligations in the amended *Environment Protection Act 2017 (VIC)* continue to put the onus of determining the appropriate risk-management control on the regulated entity and are not prescriptive about what activities may be required in order to discharge the obligation. Such obligations align with the way many businesses and industries already manage risk. This concept is familiar to businesses through the well-established model of protection provided by Victoria's Occupational Health and Safety laws, which are also centred around a general duty to take reasonably practicable measures to reduce the risk of harm.³⁸ The EPA in administering the framework adopts a proportionate, risk-based and evidence-based approach guided by historical knowledge of sites for businesses to discharge their obligations.³⁹ Further, we understand that the amended *Environment Protection Act 2017 (VIC)* largely carries over the existing quantitative thresholds for particular contaminants. As noted above, the duty to manage contaminated land under section 39 of the amended *Environment Protection Act 2017 (VIC)*⁴⁰ will involve obligations that are comparable to those under the current environment protection framework (in particular, under the State Environment Protection Policy (Prevention and Management of Contamination of Land) clauses 18 and 21). It is reasonable to expect that most modern companies with existing environmental management systems would be in a good place to manage these obligations.

We expect AusNet Services would already hold extensive knowledge and information about the condition, performance and environmental risks of its sites and assets from its historical business as usual inspections and testing and maintenance of these sites. Further, that there should be existing environmental management plans covering sites and assets under current environmental protection obligations. We asked AusNet Services to explain how its obligations to manage land remediation have changed with the revised environment protection regime, and provide examples of the likely impacts.⁴¹ We have not received sufficient information from AusNet Services regarding these issues.

³⁷ Both the current environment protection framework (via State Environment Protection Policy (Prevention and Management of Contamination of Land)) and the new environment protection framework (via the Environment Protection Regulations 2021 and the Environment Reference Standard) reference the National Environment Protection (Assessment of Site Contamination) Measure, as part of establishing requisite environmental benchmarks relating to the management of contaminated/polluted land.

³⁸ Environment, Water, Land and Planning Victoria, *Environment Protection Amendment Act 2018 – Fact Sheet*, p. 1.

³⁹ Environment Protection Authority Victoria, *1915: Contaminated land policy*, p. 7.

⁴⁰ Prior to 1 July 2021, this section can be found in the Environment Protection Amendment Act 2018, Part 2—Amendments to the Environment Protection Act 2017, pp. 47–49.

⁴¹ AusNet Services, *Information request 14*, April 2021.

Overall, we consider that cost pass through events should be the last option available for network businesses to recover costs in order to protect the incentive mechanisms of our framework. The NER cost pass through framework is intended to ensure pass through events should only be accepted when it is the least inefficient option and event avoidance, mitigation and insurance are found to be inappropriate. In this regard it is also important to assess whether the cost pass through mechanism is consistent with AusNet Services retaining incentives to continuously manage and mitigate such risks. At this stage, AusNet Services has not provided a clear case that it is appropriate that any future contamination remediation costs should be managed via a nominated pass through event, particularly in terms of the actions it has taken (and will take) to manage and mitigate such risks. AusNet Services has the opportunity to provide the further details, as noted above, in order for us to reconsider whether there is case to accept a nominated contamination remediation pass through event in our final decision. Alternatively, given the revised environment protection regime will take some years for its potential impacts to be realised, AusNet Services may consider monitoring its impact and whether its opex forecasts for the subsequent regulatory control period include these costs.

Unlike a natural disaster pass through event, or even the Ministerial power to direct augmentation event discussed below, AusNet Services has far greater influence within its actions to manage and mitigate the risks associated with the obligations to manage and remediate contaminated land. If we were to accept this pass through event, the incentive on AusNet Services and other service providers to proactively manage land contamination and remediation risks and adopt best practices would likely be significantly reduced.

Accordingly, our draft decision is to not accept the nominated pass through event as currently proposed by AusNet Services.

13.4.4 Major cyber event

Our draft decision is to not include the major cyber event proposed by AusNet Services.

AusNet Services proposed a new pass through event for major cyber events based on its view that cyber events could fall outside the terrorism event definition and/or the inability to determine motivation of the perpetrators of a major cyber-attack.⁴²

We accept that the occurrence of major cyber events, as defined, cannot be completely ruled out. 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. We consider it is appropriate for network service providers to be incentivised to 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.

⁴² AusNet Services, *Revenue Proposal 2023–27*, 29 October 2020, pp. 234–238.

If we were to accept this pass through event, the incentive on AusNet Services and other service providers to proactively manage cyber security risks and adopt best practices would likely be significantly reduced. Although AusNet Services has no control on what third parties do, it controls the cyber security and protection of its information and communications technology systems and assets, which affect its susceptibility to cyber-attacks and the likelihood of a major cyber event. AusNet Services 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 AusNet Services 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.

Our recent decisions to not accept a major cyber pass through event are because we consider cyber security risk is one of the key business risks an energy network service provider faces. We consider this risk should be largely borne by the network service provider, who is best placed to manage it, rather than consumers. We consider accepting the broadly defined proposed major cyber event is likely to have the effect of passing AusNet Services' cyber-security risk to consumers and eroding its incentives to manage this risk efficiently and prudently.

While our recent decisions were predominantly for distribution networks, we have also examined whether a transmission service provider faces higher risk related to cyber security than a distributor. Our technical advice suggests that a transmission service provider's ICT systems are generally more robust against cyber-attack than distribution networks. In the event of a transmission network collapse, it could lead to a shut-down of energy delivery from major power plants and takes 24-48 hours to restart the power system. AEMO's Australian Energy Sector Cyber Security Framework (AESCSF) puts transmission businesses at the very top of the high risk category. We would agree with AusNet Services that one key consideration for it to manage its cyber risks is that it is provided with an efficient and prudent level of expenditure to meet the requirements of the Maturity Indicator Level (MIL) 3 standards set by the AESCSF.⁴³

Consistent with this, our recent decisions emphasised that all Australian utility providers operate national critical infrastructure and are subject to stringent cyber security compliance requirements. We expect AusNet Services would have appropriate safeguards or contingency plans to substantially mitigate the risks and cost impacts of major cyber-attacks. Supporting this, our draft decision assesses AusNet Services' proposed total capital and operating expenditure for cyber security information and communications technology improvements. Our draft decision considers it is prudent for AusNet Services to meet the regulatory obligation requirements under MIL 3.

Further, as noted in our previous decisions for distribution businesses, the nominated 'terrorism' pass through event could include cyber-terrorism. Given the likely impacts

⁴³ AusNet Services, *Revenue Proposal 2023–27*, 29 October 2020, pp. 147–149.

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 by AusNet Services.

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

13.4.5 Victorian Energy Minister’s power to direct augmentation event

Our draft decision is to include the Victorian Energy Minister’s power to direct augmentation as a separate nominated event, with amendments to the definition proposed by AusNet Services.

AusNet Services proposed to include this new nominated pass through event because it was concerned that there may be circumstances where a new Ministerial Order, made under the amended National Electricity (Vic) Act 2005 (NEVA), may fall outside the definition of any of the prescribed regulatory change cost pass through event.⁴⁴ In particular, it considered that the obligations or requirements made under NEVA are precluded from being regulatory obligations or requirements as defined in the National Electricity Law (NEL). Further, it considered a Ministerial Order would not satisfy the requirements of the other prescribed pass through events. It considered this would result in it being unable to recover the efficient costs incurred in the event it has to comply with an order.

AusNet Services noted that amendments to the NEVA commenced on 25 March 2020.⁴⁵ These amendments provide the Victorian Minister for Energy with the power to make a Ministerial order to regulate:

- specified augmentations of the declared transmission system
- the provision of specified non-network services in respect of such augmentations
- other services that support the Victorian transmission system.⁴⁶

AusNet Services stated that the new powers are intended to accelerate transmission augmentations to improve the reliability of electricity supply.⁴⁷ It noted this may occur by (amongst other things) the Minister modifying the requirements of the Regulatory Information Test for transmission and / or providing for the recovery of costs incurred in respect of a specified augmentation or the provision of non-network services. However, it considered it is not possible to predict with any certainty how the Minister might exercise this power.

We understand that the scope of the Minister’s power is broad, giving the Minister considerable discretion in what she/he could order AusNet Services to do.

⁴⁴ AusNet Services, *Revenue Proposal 2023–27*, 29 October 2020, pp. 238–240.

⁴⁵ <https://www.legislation.vic.gov.au/bills/national-electricity-victoria-amendment-bill-2020>

⁴⁶ AusNet Services, *Revenue Proposal 2023–27*, 29 October 2020, p. 239.

⁴⁷ AusNet Services, *Revenue Proposal 2023–27*, 29 October 2020, p. 238.

We consider the proposed pass through event broadly meets most of the considerations that we need to take into account when deciding whether to accept or not accept a nominated pass through event (see section 13.3). It appears that the nature or type of event can be clearly identified and the Victorian Department of Environment, Land, Water and Planning has noted that the powers were designed to support a range of small to very large projects.⁴⁸ We also consider that event avoidance, mitigation and insurance are not possible or appropriate.

We have also examined whether the event proposed is an event already covered by a prescribed pass through event and in particular the regulatory change event. We consider that as section 16Y of the NEVA allows an Order to be made that can modify the terms and operation of the NEL in Victoria, it runs the risk that an obligation or requirement arising under an Order (made under the NEVA) may not be a new regulatory obligation. This is because it would not be covered by the definition of a "regulatory obligation or requirement" under section 2D of the NEL, which excludes obligations or requirements under national electricity legislation.

We understand from the Victorian Department of Environment, Land, Water and Planning that it would expect an Order to specify a cost recovery mechanism, but it also acknowledged that it is possible that this may not occur.⁴⁹

For the above reasons, we accept the use of a nominated pass through event. However, we are of the view that the current definition of the nominated pass through event proposed by AusNet Services should be refined to:

- ensure that AusNet Services is only able to recover any costs associated with an Order once. AusNet Services acknowledged in its initial proposal that the regulatory framework contains mechanisms to enable efficient costs to be recovered, however these mechanisms are not, or unlikely to be available to AusNet Services in all circumstances in respect of costs arising from a Ministerial Order.⁵⁰ The Victorian Department of Environment, Land, Water and Planning has also confirmed that mechanisms other than a cost pass through may be specified in an Order⁵¹
- remove references to assisting AEMO or third parties in the definition. As the event will relate to AusNet Services' compliance with an Order, however specified, it is not relevant to include details of how it may need to comply (including who it may need to work with or assist) in the definition.

Reflecting these considerations, in order to accept this event, we have made the following amendments to the definition:

⁴⁸ Victorian Department of Environment, Land, Water and Planning, *AER questions on MOs under NEVA amendments*, April 2021, p. 1.

⁴⁹ Victorian Department of Environment, Land, Water and Planning, *AER questions on MOs under NEVA amendments*, April 2021, p. 1.

⁵⁰ AusNet Services, *Revenue Proposal 2023–27*, 29 October 2020, p. 239

⁵¹ Victorian Department of Environment, Land, Water and Planning, *AER questions on MOs under NEVA amendments*, April 2021, p. 1.

A Victorian Energy Minister's power to direct augmentation event occurs if each of the following conditions are satisfied:

- (a) the Minister makes an order under section 16Y(1) of the National Electricity (Victoria) Act 2005 (Vic) (Order);
- (b) complying with the Order, ~~or assisting AEMO or a third party to comply with its obligations under the Order,~~ increases the cost to AusNet Services of providing prescribed transmission services and AusNet Services is unable to recover such cost from any other prevailing cost recovery arrangements.

Given the circumstances, our draft decision is to accept the nominated pass through event with amendments as shown above.

13.4.6 Summary of accepted nominated pass through events for draft decision

Table 13.2 summarises the nominated pass through events accepted by us in the draft decision.

Table 13.2 AER nominated pass through event definitions

Proposed event	Proposed definition
Insurance coverage event	An insurance coverage event occurs if:
	1. AusNet Services:
	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. AusNet Services 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 AusNet Services in providing direct control services.
	For the purposes of this insurance coverage event:
	'changed circumstances' means movements in the relevant insurance liability market that are beyond the control of AusNet Services, where those movements mean that it is no longer possible for AusNet Services to take out an insurance policy or set of insurance 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.
'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; or	
ii. 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 AusNet Services was regulated; and	
AusNet Services 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 AusNet Services in relation to any aspect of AusNet Services' network or business; and	
AusNet Services 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 AusNet Services in relation to any aspect of AusNet Services' 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 TNSP would obtain, or would have sought to obtain, in respect of the event;	
iii. any information provided by AusNet Services to the AER about AusNet Services' 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.	

Proposed event	Proposed definition
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> <p>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 changes the costs to AusNet Services in providing direct control services.</p> <p>Note: In assessing a terrorism event pass through application, the AER will have regard to, amongst other things:</p> <ol style="list-style-type: none"> i. whether AusNet Services has insurance against the event; ii. the level of insurance that an efficient and prudent NSP 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.
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 2021–26 regulatory control period that changes the costs to AusNet Services in providing direct control services, provided the cyclone, fire, flood, earthquake or other event was:</p> <ol style="list-style-type: none"> 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 b) not a consequence of any other act or omission of the service provider. <p>Note: In assessing a natural disaster event pass through application, the AER will have regard to, amongst other things:</p> <ol style="list-style-type: none"> (1) whether AusNet Services has insurance against the event; (2) the level of insurance that an efficient and prudent NSP would obtain in respect of the event.
Insurer credit risk event	<p>An insurer credit risk event occurs if an insurer of AusNet Services becomes insolvent, and as a result, in respect of an existing or potential claim for a risk that was insured by the insolvent insurer, AusNet Services:</p> <ol style="list-style-type: none"> 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. <p>Note: in assessing an insurer credit risk event pass through application, the AER will have regard to, amongst other things:</p> <ol style="list-style-type: none"> i. AusNet Services' 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 AusNet Services had reasonable opportunity to insure the risk with a different provider.
Victorian Energy Minister's power to direct augmentation event	<p>Victorian Energy Minister's power to direct augmentation event occurs if each of the following conditions are satisfied:</p> <ol style="list-style-type: none"> a) the Minister makes an order under section 16Y(1) of the National Electricity (Victoria) Act 2005 (Vic) (Order); b) complying with the Order, increases the cost to AusNet Services of providing prescribed transmission services and AusNet Services is unable to recover such costs from any other prevailing cost recovery arrangements.

Source: AER analysis

Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
capex	capital expenditure
CESS	capital expenditure sharing scheme
EBSS	efficiency benefit sharing scheme
NEL	national electricity law
NEO	national electricity objective
NER	national electricity rules
opex	operating expenditure
RAB	regulatory asset base
RPP	revenue and pricing principles
