

# Draft Decision

## ElectraNet Transmission Determination 2023 to 2028

(1 July 2023 to 30 June 2028)

### Attachment 13 Pass through events

September 2022

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#### **Amendment record**

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## Note

This attachment forms part of the AER’s draft decision on ElectraNet’s 2023–28 transmission determination. It should be read with all other parts of the draft decision.

The draft decision includes the following documents:

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

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Attachment 13 – Pass through events

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## 13 Pass through events

During the regulatory control period ElectraNet 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 ElectraNet to recover the efficient costs incurred as a result of events that could not be forecast as part of its regulatory proposal that otherwise would have a significant financial effect on ElectraNet's ability to invest in and operate its networks.<sup>1</sup>

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

- a regulatory change event
- a service standard event
- a tax change event
- an insurance event
- an inertia shortfall event
- a fault level shortfall event.

In addition to these prescribed events, other pass through events may be 'nominated' by a service provider to be specified in a transmission determination as a pass through event for a regulatory control period.<sup>3</sup> This attachment sets out our draft decision on the nominated pass through events to apply to ElectraNet for the 2023–28 regulatory control period (2023–28 period).

### 13.1 Draft decision

Our draft decision pursuant to clause 6A.14.1(9) of the NER is to is to:

- accept four of ElectraNet's proposed nominated pass through events (being the terrorism, natural disaster, insurance coverage and insurer's credit risk events), subject to minor amendments to the terrorism and insurance coverage pass through event definitions, to ensure consistency with our recent decisions for other network service providers; and
- not accept ElectraNet's proposed Renewable Energy Zone (REZ) design report and system strength services pass through event.

Our reasons are set out in section 13.4 and our amended definitions in Table 13.2.

### 13.2 ElectraNet's proposal

ElectraNet's proposed nominated pass through events are set out in Table 13.1.

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

<sup>2</sup> NER r. 6A.7.3(a1)(1)–(4) and (5)–(7).

<sup>3</sup> NER, r. 6A.7.3(a1)(5).

**Table 13.1 ElectraNet’s proposed nominated pass through events**

Proposed event	Proposed definition
Insurance coverage event	<p>1. ElectraNet</p> <ul 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> </ul> <p>2. ElectraNet incurs costs:</p> <ul 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> </ul> <p>3. The costs referred to in paragraph 2 above materially increase the costs to ElectraNet in providing prescribed transmission services.</p> <p>For the purposes of this insurance coverage event:</p> <p>'changed circumstances' means movements in the relevant insurance market since the acquisition of the insurance policy or set of insurance policies that applied during the majority of ElectraNet’s base year and that are beyond the reasonable control of ElectraNet, where those movements result in it no longer being prudent or efficient for ElectraNet to take out with a reputable insurer:</p> <ul style="list-style-type: none"> <li>i. a relevant insurance policy; or</li> <li>ii. in the case of a set of insurance policies, one or more layers of insurance within that set (or there are otherwise one or more gaps within the set), either at all or on commercial terms reasonable to ElectraNet.</li> </ul> <p>'costs' means the costs, including the costs of cyber attacks, that would have been recovered under the insurance policy or set of insurance policies had:</p> <ul style="list-style-type: none"> <li>iii. the limit not been exhausted;</li> <li>iv. those costs not been unrecoverable due to changed circumstances.</li> </ul> <p>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 ElectraNet was regulated; and</p> <ul style="list-style-type: none"> <li>i. ElectraNet 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 ElectraNet in relation to any aspect of ElectraNet’s network or business; and</li> <li>ii. ElectraNet 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</li> </ul>

Proposed event	Proposed definition
	<p>related party of ElectraNet in relation to any aspect of ElectraNet's network or business.</p> <p>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:</p> <ul style="list-style-type: none"> <li>i. the relevant insurance policy or set of insurance policies for the event;</li> <li>iii. the level of insurance that an efficient and prudent Transmission Network Service Provider (TNSP) would obtain, or would have sought to obtain, in respect of the event;</li> <li>iv. any information provided by ElectraNet to the AER about ElectraNet's actions and processes; and</li> <li>v. 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>
<p>Insurer's credit risk event</p>	<p>An insurer credit risk event occurs if an insurer of ElectraNet becomes insolvent, and as a result, in respect of an existing or potential claim for a risk that was insured by the insolvent insurer, ElectraNet:</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> <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. ElectraNet's attempts to mitigate and prevent the event from occurring by reviewing and considering the insurer's track record, size, credit rating and reputation; and</li> <li>ii. in the event that a claim would have been covered by the insolvent insurer's policy, whether ElectraNet had reasonable opportunity to insure the risk with a different provider.</li> </ul>
<p>Natural disaster event</p>	<p>Natural disaster event means any natural disaster including but not limited to cyclone, fire, flood or earthquake that occurs during the 2023–24 to 2027–28 regulatory control period that changes the costs to ElectraNet in providing prescribed transmission services, provided the cyclone, fire, flood, earthquake or other event was:</p> <ul style="list-style-type: none"> <li>a) not 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 ElectraNet has insurance against the event; and</li> <li>ii. the level of insurance that an efficient and prudent Network Service Provider (NSP) would obtain in respect of the event.</li> </ul>

Proposed event	Proposed definition
Terrorism event	<p>A 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 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</li> <li>2. changes the costs to ElectraNet in providing prescribed transmission services.</li> </ol> <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"> <li>i. whether ElectraNet has insurance against the event;</li> <li>iii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event; and</li> <li>iv. whether a declaration has been made by a relevant government authority that a terrorism event has occurred.</li> </ol>
REZ design report	<p>A REZ design report event occurs if:</p> <ol style="list-style-type: none"> <li>a) ElectraNet is required to commence preparation of one or more REZ design reports during the 2023–27 to 2027–28 regulatory control period in accordance with clause 5.24.1(b) of the National Electricity Rules; and</li> <li>b) ElectraNet will incur increased costs in preparing one or more REZ design reports. For the purpose of this event, the eligible pass through amount is the actual cost incurred by ElectraNet in preparing the REZ design reports in one or more regulatory years and is not subject to a materiality threshold.</li> </ol> <p>Note: in assessing a REZ design report event pass through application, the AER will have regard to, amongst other things:</p> <ol style="list-style-type: none"> <li>i. the need to ensure that ElectraNet has a reasonable opportunity to recover the total efficient costs of preparing REZ design reports; and</li> <li>vi. the urgency of the request to complete the design report or reports.</li> </ol>
System strength services	<p>A system strength services event occurs if ElectraNet:</p> <ol style="list-style-type: none"> <li>a) signs or intends to sign a contract or contracts for system strength services to be made available or provided in ElectraNet’s capacity as a System Strength Service Provider to satisfy an obligation under clause 5.20C.3 of the National Electricity Rules;</li> <li>b) the amount paid or to be paid for those system strength services in a regulatory year is more than 1% of the maximum allowed revenue for that regulatory year; and</li> </ol> <p>the system strength services are made available or provided in accordance with applicable technical specifications and performance standards approved by AEMO.</p>



Proposed event	Proposed definition
	<p>Note: in assessing a system strength service pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> <li>i. the need to ensure that ElectraNet has a reasonable opportunity to recover the total efficient costs of providing system strength services; and</li> <li>ii. the urgency in meeting the system strength obligation and the options or lack of options available to ElectraNet in those circumstances.</li> </ul>

Source: ElectraNet, *Attachment 12 – Pass through events Revenue Proposal 2023–24 to 2027–28*, 31 January 2022, pp. 6–16.

### 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<sup>4</sup> and the revenue and pricing principles.<sup>5</sup> These principles provide, relevantly, 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>6</sup> They also reflect the importance of incentives to promote economic efficiency<sup>7</sup> and balance the risks of under and over investment.<sup>8</sup> 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', which are as follows:<sup>10</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;

<sup>4</sup> NEL, s. 7.

<sup>5</sup> NEL, s.7A(2)– (7).

<sup>6</sup> NEL, s. 7A(2).

<sup>7</sup> NEL, s.7A(3).

<sup>8</sup> NEL, s. 7A(6).

<sup>9</sup> NEL, s. 7; AEMC, *Cost pass through arrangements for Network Service providers*, Rule Determination, 2 August 2012, p. 6.

<sup>10</sup> NER, Chapter 10, definition of nominated pass through event consideration.

- 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
  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. That is, a cost pass through event is the least efficient option for managing the risk of unforeseen events.<sup>11</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>12</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.<sup>13</sup> 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 and gas determinations.<sup>15</sup>

### 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) and capital expenditure

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<sup>11</sup> AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 19.

<sup>12</sup> AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 20.

<sup>13</sup> AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 8.

<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.

(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).

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>16</sup>

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.<sup>17</sup> This is reflected in the materiality threshold that applies to cost pass throughs applications.<sup>18</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>19</sup>

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 for the next regulatory period.<sup>20</sup>

## 13.4 Reasons for draft decision

### 13.4.1 Insurance coverage, Credit risk, Natural disaster and terrorism events

Our draft decision is to include these events, subject to amendments being made to the definitions proposed by ElectraNet on the terrorism and insurance coverage events. We have

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<sup>16</sup> AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 19–20.

<sup>17</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>18</sup> NER, Chapter 10: Glossary, definition of 'materially'.

<sup>19</sup> AER, *Efficiency Benefit Sharing Scheme for Electricity Network Service Providers*, November 2013, p. 7; AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013, p. 14.

<sup>20</sup> NER, cl. S6.2.1(e)(1)(ii) and 6A.2.1(f)(1)(ii).

included amended wording for these definitions, in part to maintain consistency with other recent decisions.<sup>21</sup> ElectraNet included additional terms which are discussed in the following sections.

### 13.4.2 Terrorism definition

In characterising the nature of a terrorism act, ElectraNet has proposed to refer to an act which 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).

We have removed the proposed reference to ‘or appears to be done’ to ensure consistency with other recent AER decisions. We consider that this minor change will assist to ensure that this type of event is clearly identifiable and able to be assessed objectively. We expect that this minor change to the definition will not have a significant impact on how this nominated pass through event is to apply for ElectraNet’s 2023–28 regulatory control period.

#### 13.4.2.1 Insurance coverage

ElectraNet proposed a number of definitional amendments to the insurance coverage event,<sup>22</sup> which are essentially the same as those proposed by the Victorian electricity distributors and AusNet Services (transmission) as part of the process for their 2021–26 and 2022–27 determinations, respectively (see below).<sup>23</sup> The amendments proposed by the Victorian electricity distributors and AusNet Services (transmission) 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,<sup>24</sup> we inserted three key changes to the definition:

- "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

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<sup>21</sup> AER, *Final decision, AusNet Services Distribution Determination 2021 to 2026, Attachment 15 – Pass through events*, April 2021, p.8; AER, *Final decision, Powercor distribution determination 2021 to 2026, Attachment 15 Pass through events*, April 2021, p. 15–17; AER, *Draft decision, Powerlink transmission determination 2022 to 2027, Attachment 12 Pass through events*, September 2021, p. 13; AER, *Final decision, AusNet Services transmission determination 2022 to 2027, Attachment 13 Pass through events*, September 2021, pp. 6–7.

<sup>22</sup> ElectraNet, *Attachment 12 – Pass through events Revenue Proposal 2023–24 to 2027–28*, 31 January 2022, pp. 7–11.

<sup>23</sup> Jemena, *2021–26 Electricity Distribution Price Review Revised Regulatory Proposal Attachment 08–01 Response to the AER’s draft decision – Risk Management – Cost pass-through*, December 2020, pp. 1–3; AusNet Services, *Electricity Distribution Price Review 2022–26 Revised Regulatory Proposal*, 3 December 2020, pp. 154–155; Ausnet Services, *2023–27 Transmission Revenue Reset Revenue Proposal*, 29 October 2020, pp. 228–230.

<sup>24</sup> AER, *Final Decision, SA Power Networks Distribution Determination 2020 to 2025, Attachment 14 Pass through events*, June 2020, p. 5; AER, *Final Decision, Ergon Energy Distribution Determination 2020 to 2025, Attachment 14 Pass through events*, June 2020, p. 5; AER, *Final Decision, Energex Distribution Determination 2020 to 2025, Attachment 14 Pass through events*, June 2020, p. 5.

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:
  - a) the limit not been exhausted; or
  - b) 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.

In this draft decision, we have largely maintained the insurance coverage definition that we applied to other service providers in recent decisions.<sup>25</sup> We consider it would be preferable to maintain a consistent definition across network businesses as much as possible, rather than update the definition with the minor amendments proposed by ElectraNet. The amendments proposed by ElectraNet that we have not accepted include:<sup>26</sup>

- reflecting that some insurance policies of this kind consist of layers, and that a change of circumstances might affect one or more of the layers that make up an insurance policy held by ElectraNet during the relevant regulatory control period
- removing the reference to 'liability' when clarifying the meaning of "changed circumstances" to clarify that the pass through is not limited to events relating to ElectraNet's liability insurance cover
  - While we do not accept the change proposed by ElectraNet, we have made a minor amendment to reflect that the scope of the insurance coverage event is broader than liability insurance. We have replaced:

'changed circumstances' means movements in the relevant insurance liability market that are beyond the control of ElectraNet, where those movements mean that it is no longer possible for ElectraNet to take out an insurance policy or set of insurance policies at all or on reasonable commercial terms that

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<sup>25</sup> AER, *Final Decision, SA Power Networks Distribution Determination 2020 to 2025, Attachment 14 Pass through events*, June 2020, p. 5; AER, *Final Decision, Ergon Energy Distribution Determination 2020 to 2025, Attachment 14 Pass through events*, June 2020, p. 5; AER, *Final Decision, Energex Distribution Determination 2020 to 2025, Attachment 14 Pass through events*, June 2020, p. 5; AER, *Final Decision, AusNet Services Transmission Determination 2022 to 2027 Attachment 13 Pass through events*, April 2022, p. 22.

<sup>26</sup> ElectraNet, *Attachment 12 – Pass through events Revenue Proposal 2023–24 to 2027–28*, 31 January 2022, p. 8.

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’

with the following

‘changed circumstances’ means movements in the relevant **insurance market, including liability insurance**, that are beyond the control of ElectraNet, where those movements mean that it is no longer possible for ElectraNet 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’.

- additional words to clarify that the term ‘costs’ is defined to include the costs of cyber-attacks.

In regard to the reference to costs relating to cyber attacks, one of the key factors under the NER nominated cost pass through event considerations, is whether a prudent service provider could reasonably prevent an event of a specified nature or type from occurring or substantially mitigate the cost impact of such an event. We consider it 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 prescribed services. If we were to accept the inclusion of cyber attack costs, the incentive on ElectraNet and other service providers to proactively manage cyber security risks and adopt best practices would likely be significantly reduced. Although ElectraNet 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. ElectraNet has a regulatory obligation to maintain the security of supply of electricity and an incentive to ensure the security of its network systems are sufficiently robust and resilient to withstand cyber threats, such that a major interruption to its technology systems and assets would not occur. We consider ElectraNet 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.

- A further amendment proposed by ElectraNet is that "changed circumstances" should mean:

movements in the relevant insurance market since the acquisition of the insurance policy or set of insurance policies that applied during the majority of ElectraNet’s base year and that are beyond the reasonable control of ElectraNet, where those movements result in it no longer being prudent or efficient for ElectraNet to take out with a “reputable insurer.”<sup>27</sup>

We consider that the decision for ElectraNet to seek appropriate insurance cover on reasonable commercial terms is solely in the domain of the business, and we expect that ElectraNet will safeguard that business decision. We do not consider it necessary to

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<sup>27</sup> ElectraNet, *Attachment 12 – Pass through events Revenue Proposal 2023–24 to 2027–28*, 31 January 2022, p. 7.

prescribe the insurers who ElectraNet may seek coverage from. We have not accepted this proposed amendment.

Our amended definitions are set out in Table 13.2.

### 13.4.3 REZ design report

Our draft decision is to not accept the REZ design report event as proposed by ElectraNet. We consider the proposed definition, which excludes the materiality threshold, is inconsistent with the requirements of the NER, such that it cannot be accepted. We note the NER’s definition of “positive change event” and “negative change event” requires the application of the materiality threshold, and we consider this may not be bypassed in the definition for a proposed nominated pass through event.<sup>28</sup>

ElectraNet proposed a REZ design report event to provide cost recovery for the preparation of REZ design reports in accordance with a new planning rule that was introduced in May 2021.<sup>29</sup> While recognising that currently it has not been required to provide any REZ design reports, ElectraNet considered it reasonably likely that AEMO will require one or more REZ design reports to be completed during the 2023–28 period.<sup>30</sup>

ElectraNet proposed not to apply a materiality threshold to costs relating to this event, stating that the eligible pass through amount is to be the actual cost incurred by it in preparing the REZ design reports in one or more regulatory years (see Table 13.1).<sup>31</sup>

We have received one submission from the South Australia Government, which disagreed with ElectraNet’s view relating to the materiality threshold.<sup>32</sup> This submission submitted that the materiality threshold should apply to costs associated with REZ design reports.<sup>33</sup> The South Australia Government’s submission stated that ElectraNet’s proposal is inconsistent with the recommendations of the Energy Security Board (ESB). The ESB recommended that the costs associated with REZ design reports are to be subject to the minimum cost pass through threshold.<sup>34</sup>

We have considered the proposed REZ design report event, having regard to the nominated pass through event considerations that we need to have regard to when deciding whether to accept or not accept a nominated pass through event (see section 13.3). We acknowledge that certain aspects of the proposed event may not be possible to clearly identify, noting that ElectraNet may be required to prepare and publish a REZ design report under the NER.<sup>35</sup>

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<sup>28</sup> NER, chapter 10.

<sup>29</sup> ElectraNet, Attachment 12 – Pass through events Revenue Proposal 2023–24 to 2027–28, 31 January 2022, p. 5.

<sup>30</sup> ElectraNet, Attachment 12 – Pass through events Revenue Proposal 2023–24 to 2027–28, 31 January 2022, p. 13.

<sup>31</sup> ElectraNet, Attachment 12 – Pass through events Revenue Proposal 2023–24 to 2027–28, 31 January 2022, p. 12.

<sup>32</sup> Government of South Australia, Letter to AER, 21 June 2022., p. 3.

<sup>33</sup> Government of South Australia, Letter to AER, 21 June 2022., p. 3.

<sup>34</sup> Energy Security Board, *Renewable Energy Zones planning, Final recommendations*, February 2021, p. 17.

<sup>35</sup> NER, cl. 5.24.2.

Further, we note that the event appears unlikely to be covered by the prescribed pass through events specified in clause 6A.7.3(a1)(1) to (4) of the NER.

However, we agree with the South Australia Government that the materiality threshold should (and indeed must) be applied in accordance with the NER, and accordingly we do not accept the REZ design report event as proposed by ElectraNet. When assessing a cost pass through application under the NER, we are required, among other things, to determine whether a relevant event qualifies as a “positive change event” or a “negative change event”. The definition of positive change event and negative change event in the NER require that, in order for ElectraNet to pass through any variance in its costs, that variance must be material (meaning it must exceed 1% of a TNSP’s maximum allowed revenue (MAR) in any regulatory year).<sup>36</sup> We consider these requirements cannot be bypassed by specifying a different materiality threshold in the definition for a nominated pass through event.

#### 13.4.4 System strength services

Our draft decision is not to accept ElectraNet’s proposed system strength services event. We do not consider that this proposed event is necessary to enable ElectraNet to recover costs associated with the provision of system strength services in ElectraNet’s capacity as a System Strength Service Provider.<sup>37</sup> The AEMC’s recent determination for the *Efficient Management of System Strength on the Power System* rule change considered the framework for recovery of these costs, and concluded that the NER (as amended) provided appropriate cost recovery mechanisms for System Strength Service Providers to recover these system strength service costs.

In October 2021, the AEMC made a new rule relating to the supply, coordination and demand for system strength services.<sup>38</sup> ElectraNet submitted that to meet the system strength standard, it may need to build new network infrastructure (e.g., synchronous generators) or contract with existing synchronous generators or batteries or other plant providing fast frequency response as the most efficient solution.<sup>39</sup> The proposed system strength services event relates to cost recovery arrangements for a non-network solution, such as contracting with a generator to provide system strength services. ElectraNet recognised that, while the NER currently provides for recovery arrangements as a network support payment, this would result in a two-year lag in cost recovery. ElectraNet considered such a lag is undesirable, particularly if the costs of a non-network solution are material (e.g., if costs exceed 1% of the TNSP’s annual revenue requirement).

We understand that similar issues to those raised by ElectraNet were also raised by Powerlink during the AEMC’s rule determination consultation.<sup>40</sup> The AEMC concluded:<sup>41</sup>

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<sup>36</sup> NER, Chapter 10: Glossary, definition of ‘materially’.

<sup>37</sup> ElectraNet, Attachment 12 – Pass through events Revenue Proposal 2023–24 to 2027–28, 31 January 2022, pp. 14–15.

<sup>38</sup> AEMC, *Rule determination, National Electricity Amendment (Efficient management of system strength on the power system) Rule 2021*, 21 October 2021.

<sup>39</sup> ElectraNet, Attachment 12 – Pass through events Revenue Proposal 2023–24 to 2027–28, 31 January 2022, p. 14.

<sup>40</sup> AEMC, *Rule determination Efficient management of system strength*, 21 October 2021, p. 122.

<sup>41</sup> AEMC, *Rule determination Efficient management of system strength*, 21 October 2021, p. 198.



The Commission notes Powerlink’s concern that System Strength Service Providers may need to pay significant amounts to generators for system strength services, which may have impacts on System Strength Service Providers’ working capital. The final rule does not contain any changes to address this issue. System Strength Service Providers can recover these costs through the existing network support pass through provisions. This will minimise the impact on System Strength Services Providers and allow them to recover their actual costs on an annual basis, although it is acknowledged there will still be a lag between when the costs are incurred and when they are recovered under that pass through process.

In our view, ElectraNet’s proposed system strength services event essentially seeks to replicate the prescribed fault level shortfall event, which the AEMC determined to remove from the NER in its October 2021 determination (effective on 1 December 2022). The fault level shortfall event will still be taken to be a pass through event under transitional arrangements until 1 December 2025.

We are not satisfied that the proposed system strength service event is necessary to enable ElectraNet to recover material increases in system strength service costs, or that the recovery of system strength service costs by way of the proposed event would be consistent with how the AEMC has provided for the recovery of such costs. The AEMC explicitly considered the issue of cost recovery relating to the provision of system strength services under the existing network support cost pass through provision, including the time lag raised by ElectraNet, but determined to:

- repeal the fault level shortfall event (following a transition period which extends into ElectraNet’s 2023–28 regulatory control period), and
- specify the existing network support pass through provision as the mechanism through which System Strength Service Providers can recover system strength services costs that are not part of a contingent project.<sup>42</sup>

We also note that the event proposed appears to be covered by the fault level shortfall event, which is already taken to be an additional pass through event specified in clause 6A.7.3(a1) for the period until 1 December 2025. During this time, the fault level shortfall event remains available to ElectraNet.<sup>43</sup> Accordingly, it is our view that it is already open to ElectraNet to make timely recovery of material costs using the existing fault level shortfall event up until the end of the transition period, and through existing network support pass through provisions after that time.

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<sup>42</sup> AEMC, *Rule determination Efficient management of system strength*, 21 October 2021, p. 198.

<sup>43</sup> NER, cl. 11.143.16(b)

**Table 13.2 AER’s draft decision nominated pass through events**

Proposed event	Draft decision definition
Insurance coverage event	<p>An insurance coverage event occurs if:</p> <ol style="list-style-type: none"> <li>1. ElectraNet: <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. ElectraNet 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 ElectraNet in providing prescribed transmission services.</li> </ol> <p>For the purposes of this insurance coverage event:</p> <p>'changed circumstances' means movements in the relevant insurance market, including liability insurance, that are beyond the control of ElectraNet, where those movements mean that it is no longer possible for ElectraNet 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.</p> <p>'costs' means the costs that would have been recovered under the insurance policy or set of insurance policies had:</p> <ol style="list-style-type: none"> <li>i. the limit not been exhausted; or</li> <li>ii. those costs not been unrecoverable due to changed circumstances.</li> </ol> <p>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 ElectraNet was regulated; and</p> <p>ElectraNet 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 ElectraNet in relation to any aspect of ElectraNet’s network or business; and</p> <p>ElectraNet 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 ElectraNet in relation to any aspect of ElectraNet’s network or business.</p> <p>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:</p> <ol 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 TNSP would obtain, or would have sought to obtain, in respect of the event;</li> <li>iii. any information provided by ElectraNet to the AER about ElectraNet’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> </ol>
Insurer’s credit risk event	<p>An insurer credit risk event occurs if an insurer of ElectraNet becomes insolvent, and as a result, in respect of an existing or potential claim for a risk that was insured by the insolvent insurer, ElectraNet:</p> <ol 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> </ol>

Proposed event	Draft decision definition
	<p>b) incurs additional costs associated with funding an insurance claim, which would otherwise have been covered by the insolvent insurer.</p> <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. ElectraNet’s attempts to mitigate and prevent the event from occurring by reviewing and considering the insurer’s track record, size, credit rating and reputation; and</li> <li>ii. in the event that a claim would have been covered by the insolvent insurer’s policy, whether ElectraNet had reasonable opportunity to insure the risk with a different provider.</li> </ul>
<p>Natural disaster event</p>	<p>Natural disaster event means any natural disaster including but not limited to cyclone, fire, flood or earthquake that occurs during the 2023–24 to 2027–28 regulatory control period that changes the costs to ElectraNet in providing prescribed transmission 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 ElectraNet 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>
<p>Terrorism event</p>	<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 ElectraNet in providing prescribed transmission 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 ElectraNet 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

## Glossary

Term	Definition
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
Capex	Capital expenditure
ESB	Energy Security Board
MAR	Maximum allowed revenue
NEL	National Electricity Law
NER	National Electricity Rules
NSP	Network Service Provider
Opex	Operating expenditure
REZ	Renewable energy zone
RPP	Revenue and pricing principles
TNSP	Transmission Network Service Provider

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