



FINAL DECISION
Powercor distribution
determination
2016 to 2020

Attachment 15 – Pass through
events

May 2016

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Note

This attachment forms part of the AER's final decision on Powercor's distribution determination for 2016–20. It should be read with all other parts of the final decision.

The final decision includes the following documents:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Value of imputation credits

Attachment 5 – Regulatory depreciation

Attachment 6 – Capital expenditure

Attachment 7 – Operating expenditure

Attachment 8 – Corporate income tax

Attachment 9 – Efficiency benefit sharing scheme

Attachment 10 – Capital expenditure sharing scheme

Attachment 11 – Service target performance incentive scheme

Attachment 12 – Demand management incentive scheme

Attachment 13 – Classification of services

Attachment 14 – Control mechanisms

Attachment 15 – Pass through events

Attachment 16 – Alternative control services

Attachment 17 – Negotiated services framework and criteria

Attachment 18 – f-factor scheme

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Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AMI	Advanced metering infrastructure
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
DRP	debt risk premium
DMIA	demand management innovation allowance
DMIS	demand management incentive scheme
distributor	distribution network service provider
DUoS	distribution use of system
EBSS	efficiency benefit sharing scheme
ERP	equity risk premium
Expenditure Assessment Guideline	Expenditure Forecast Assessment Guideline for Electricity Distribution
F&A	framework and approach
MRP	market risk premium
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider
opex	operating expenditure
PPI	partial performance indicators
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia

Shortened form	Extended form
repex	replacement expenditure
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue and pricing principles
SAIDI	system average interruption duration index
SAIFI	system average interruption frequency index
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
WACC	weighted average cost of capital

15 Pass through events

During the regulatory control period, a service provider can apply to us to pass material changes in its costs arising from pre-defined exogenous events through to customers, in the form of higher or lower network charges. These events are called cost pass through events. Positive pass throughs exist in the rules as a mechanism to allow service providers to recover their efficient costs incurred as a result of events that could not be forecast as part of their proposal that otherwise would have a significant financial effect on the ability of networks to invest in and operate their networks.¹

The NER include the following pass through events for all distribution determinations:²

- a regulatory change event
- a service standard event
- a tax change event
- a retailer insolvency event³.

In addition to these prescribed events, other (nominated) pass through events may be specified in a determination for a regulatory control period.⁴

This attachment sets out our final decision on the nominated pass through events that will apply to Powercor for the 2016-20 regulatory control period.

15.1 Final decision

Our final decision is that the nominated pass through events set out in Table 15.1 will apply to direct control services provided by Powercor for the 2016–20 regulatory control period.

Table 15.1 Approved nominated pass through events

Pass through event	Definition
Insurance cap event	An insurance cap event occurs if: (a) Powercor makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy; (b) Powercor incurs costs beyond the policy limit; and

¹ AEMC 2012, *Cost Pass Through Arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 2.

² NER, cl. 6.6.1(a1)(1)–(4). Each of these prescribed events is defined in NER Chapter 10: Glossary.

³ The retailer insolvency event is not available to DNSPs in Victoria until the commencement of the National Energy Retail Law in Victoria.

⁴ NER, cl. 6.6.1(a1)(5).

Pass through event	Definition
	<p>(c) the costs beyond the policy limit increase the costs to Powercor in providing direct control services.</p> <p>For this Insurance Cap Event:</p> <p>(d) a relevant insurance policy is an insurance policy held during the 2016-20 regulatory control period or a previous regulatory control period in which PowerCor was regulated; and</p> <p>(e) Powercor will be deemed to have made a claim on a relevant insurance policy if the claim is made by a related party of Powercor in relation to any aspect of the Network or Powercor's business.</p> <p>Note in making a determination on an Insurance Cap Event, the AER will have regard to, amongst other things:</p> <p>(i) the insurance policy for the event</p> <p>(ii) the level of insurance that an efficient and prudent NSP would obtain in respect of the event, and</p> <p>(iii) any assessment by the AER of Powercor's insurance in making its distribution determination for the relevant period.</p>
Insurer credit risk event	<p>An insurer credit risk event occurs if:</p> <p>An insurer of Powercor becomes insolvent and as a result, in respect of an existing or potential insurance claim for a risk that was insured by the insolvent insurer, Powercor:</p> <p>(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</p> <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's credit risk event pass through application, the AER will have regard to, amongst other things,</p> <p>(i) Powercor's attempts to mitigate and prevent the event from occurring by reviewing and considering the insurer's track record, size, credit rating and reputation</p> <p>(ii) in the event that a claim would have been made after the insurance provider became insolvent, whether Powercor had reasonable opportunity to insure the risk with a different provider.</p>
Natural disaster event	<p>Natural disaster event means any natural disaster including but not limited to fire, flood or earthquake that occurs during the 2016–20 regulatory control period that increases the</p>

Pass through event	Definition
	<p>costs to Powercor in providing direct control services, provided the fire, flood, earthquake or other event was not a consequence of Powercor's acts or omissions.</p> <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"> (i) whether Powercor has insurance against the event, (ii) the level of insurance that an efficient and prudent NSP would obtain in respect of the event.
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> <ul style="list-style-type: none"> (a) from its nature or context is done for, or in connection with, political, religious, ideological, ethnic or similar purposes or reasons (including the intention to influence or intimidate any government and/or put the public, or any section of the public, in fear) and (b) increases the costs to Powercor in providing direct control services. <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"> (i) whether Powercor 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 an act of terrorism has occurred.
Retailer insolvency event	<p>Until such time as the National Energy Retail Law set out in the Schedule to the National Energy Retail Law (South Australia) Act 2011 of South Australia is applied as a law of Victoria, retailer insolvency event has the meaning set out in the NER as in force from time to time, except that:</p> <ul style="list-style-type: none"> (a) where used in the definition of 'retailer insolvency event' in the NER, the term 'retailer' means the holder of a licence to sell electricity under the Electricity Industry Act 2000 (Vic); and (b) other terms used in the definition of retailer insolvency event in the Rules as a consequence of amendments made to that definition from time to time, which would otherwise take their meaning by reference to provisions of the NER or

Pass through event	Definition
	<p>National Energy Retail Law not in force in Victoria, take their ordinary meaning and natural meaning, or their technical meaning (as the case may be).</p> <p>For the purposes of this definition, the terms 'eligible pass through amount' and 'positive change event' where they appear in the NER are modified in respect of this retailer insolvency event in the same manner as those terms are modified in respect of the retailer insolvency event prescribed in the NER from time to time.</p> <p>Note: This retailer insolvency event will cease to apply as a nominated pass through event on commencement of the National Energy Retail Law in Victoria.</p>

15.2 Powercor's revised proposal

Our preliminary decision⁵ approved the following nominated pass through events proposed by Powercor, but modified the definitions:

- insurance cap event
- insurer's credit risk event
- natural disaster event
- terrorism event
- retailer insolvency event.

We accepted Powercor's proposal that the pass through provisions apply to alternative control services, but did not accept its proposed modifications to the materiality threshold or recovery mechanism that apply to alternative control services.

We did not approve the two proposed by Powercor:

- end of metering derogation event
- multiple trading relationships event,

In its revised proposal, Powercor:⁶

- proposed alternative definitions for the insurance cap event, insurer's credit risk event, natural disaster event, terrorism event, and retailer insolvency event

⁵ AER, *Preliminary Decision, Powercor Distribution Determination 2016 to 2020, Attachment 15 Pass Through Events*, October 2015.

⁶ Powercor, *Revised Regulatory Proposal 2016-20*, January 2016, p. 410.

- accepted our preliminary decision to reject the end of metering derogation event and the multiple trading relationships event
- accepted our preliminary decision not to modify the materiality threshold or recovery mechanism for alternative control services

15.3 Assessment approach

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

In this decision, our task is to determine whether to accept the nominated pass through events. However, in doing so we also consider factors that may be relevant to our assessment of an application made in respect of an event, to test the workability of the event under the pass through mechanism.

15.3.1 Assessment of nominated pass through events

The NER include the following pass through events for all distribution determinations:⁷

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

They also allow a service provider to propose other events be specified in a determination as a pass through event for that determination.⁸ Our final decision must include a decision on the additional (nominated) pass through events that are to apply for the regulatory control period.⁹

Our assessment approach is guided by the National Electricity Objective (NEO) and the Revenue and Pricing Principles. These provide that the service provider should be provided with a reasonable opportunity to recover at least the efficient costs incurred in providing services and complying with its obligations.¹⁰ They also provide incentives to promote economic efficiency.¹¹ Together, they promote a balance between the economic costs and risks of the potential for under and over investment by a service provider, to promote efficient investment.¹² In the context of pass through events, we have particular regard to the impact on price, quality, reliability and security of supply

⁷ NER, cl. 6.6.1(a1)(1)–(4). Each of these prescribed events is defined in Chapter 10 (Glossary) of the NER.

⁸ NER, cl. 6.6.1(a1)(5).

⁹ NER, cl. 6.12.1(14).

¹⁰ NEL, s. 7A(2).

¹¹ NEL, s. 7A(3).

¹² NEL, s. 7A(6).

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.¹³

In determining whether we accept a nominated pass through event, we must take into account the nominated pass through event considerations:¹⁴

The *nominated pass through event considerations* are:

(a) whether the event proposed is an event covered by a category of *pass through event* specified in clause 6.6.1(a1)(1) to (4) (in the case of a distribution determination) or clause 6A.7.3(a1)(1) to (4) (in the case of a *transmission determination*);

(b) whether the nature or type of event can be clearly identified at the time the determination is made for the service provider;

(c) whether a prudent service provider could reasonably prevent an event of that nature or type from occurring or substantially mitigate the cost impact of such an event;

(d) whether the relevant service provider could insure against the event, having regard to:

(1) the availability (including the extent of availability in terms of liability limits) of insurance against the event on reasonable commercial terms; or

(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.¹⁵

¹³ NEL, s. 7; AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 6.

¹⁴ NER, cl. 6.5.10(b); NER Chapter 10: Glossary, definition of 'nominated pass through event considerations'.

¹⁵ AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 19.

- 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.¹⁶

In turn, this protects the incentive regime under the NER by limiting the erosion of incentives on service providers to use market based mechanisms to mitigate the cost impacts that would arise.¹⁷ 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.¹⁸

As a matter of good regulatory practice, one additional matter¹⁹ we take into account is consistency in our approach to assessing nominated pass through events across our electricity determinations and gas access arrangements.²⁰

Another additional matter we take into account²¹ is how an application to pass through costs after an event occurs will be assessed, and the workability of the nominated pass through event in the context of the NER cost pass through mechanism. This is discussed in section 15.3.2 below.

15.3.2 Assessment of pass through applications

A pass through event is triggered when a defined event occurs, and entails the service provider incurring materially higher (or lower) costs than it would have occurred but for that event.²² When the change in costs is positive (that is, costs increase), the service provider may seek our approval to pass through an increase in the costs that it has incurred and is likely to incur over the regulatory control period to its users.²³ When the change in costs is negative (and costs decrease), the service provider must provide us with a statement of the amount to be passed through.²⁴

The pass through mechanism does not allow a service provider to pass through any change in its actual costs resulting from an event. As the AEMC has noted:²⁵

The natural incentive properties of cost pass throughs are very weak. There is no direct financial benefit to the [service provider] from out performing in relation to those events that are covered by cost pass throughs, unlike the incentive arrangements for operating expenditure captured in the building blocks.

¹⁶ AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 20.

¹⁷ AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 8.

¹⁸ AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 8.

¹⁹ NER, Chapter 10: Glossary, definition of 'nominated pass through event considerations', cl. (e).

²⁰ AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 18.

²¹ NER, Chapter 10: Glossary, definition of 'nominated pass through event considerations', cl. (e).

²² NER, Chapter 10: Glossary, definitions of 'positive change event' and 'negative change event'.

²³ NER, cl. 6.6.1(c).

²⁴ NER, cl. 6.6.1(f).

²⁵ AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 3.

...the NER allow the AER to take into account the efficiency of the provider's decisions and actions in relation to the risk, as an attempt to impose some incentives to not overspend in relation to cost pass throughs. However, the incentives to find cost efficiencies on matters that can be claimed as cost pass through events are very poor.

A materiality threshold is first applied so that an application to pass through costs (whether positive or negative) can only be made where the total change in costs resulting from the event is more than one per cent of the annual revenue requirement for the service provider for the relevant regulatory year.²⁶

In making a determination on the amount to be passed through, we must then take into account:²⁷

- the information provided to us by the service provider
- the increase in the costs of providing direct control services that the service provider has incurred and is likely to incur (or the costs in the provision of prescribed transmission services the service provider has saved and is likely to save) until:
 - the end of the regulatory control period in which the event occurred; or
 - if the distribution determination for the regulatory control period following that in which the event occurred does not make any allowance for the recovery of that increase in costs (or the pass through of those cost savings) – the end of the regulatory control period following that in which the event occurred;
- for an increase in costs, the efficiency of the service provider's decisions and actions in relation to the risk of the event, including whether the service provider has failed to take any action that could reasonably be taken to reduce the magnitude of the eligible pass through amount in respect of that event and whether the service provider has taken or omitted to take any action where such action or omission has increased the magnitude of the amount in respect of that event;
- the time cost of money based on the allowed rate of return for the service provider for the regulatory control period in which the pass through event occurred;
- the need to ensure that the service provider only recovers any actual or likely increment in costs to the extent that such increment is solely as a consequence of a pass through event;
- in the case of the prescribed tax change event, any change in the way another tax is calculated, or the removal or imposition of another tax, which, in our opinion, is complementary to the tax change event concerned;
- whether the costs of the pass through event have already been factored into the calculation of the service provider's annual revenue requirement for the regulatory

²⁶ NER, Chapter 10: Glossary, definition of 'materially'.

²⁷ NER, cl. 6.6.1(j) / 6A.7.3.

control period in which the pass through event occurred or will be factored into the calculation of the provider's annual revenue requirement for a subsequent regulatory control period;

- the extent to which the costs that the service provider has incurred and is likely to incur are the subject of a previous determination we have made on a cost pass through application; and
- any other factors we consider relevant.

What other factors may be relevant to a particular pass through event must—to some extent—be determined on a case by case basis. However, for some events there may be additional factors that can be identified in advance. Where this is the case for nominated pass through events, we include these factors in the approved definitions of those events as part of our determination. This is good regulatory practice for two reasons:

1. It provides transparency and predictability to service providers and users, and allows service providers to address these factors directly in cost pass through applications.
2. It allows us, service providers and users to consider and engage on how a nominated pass through event will operate during the regulatory control period, and therefore to better take into account the nominated pass through event considerations when defining an approved event.

15.3.3 Interrelationships

The pass through mechanism is not the only way in which service providers can manage their risks under a distribution determination. It is interrelated with other parts of this decision, in particular with the forecast opex and capex and rate of return included in our building block 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 building block 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.²⁸

For smaller projects, a service provider should generally utilise its existing expenditure allowance or reprioritise its work program rather than seeking approval of a pass through.²⁹ This is reflected in the materiality threshold that applies to applications for cost pass through determinations.³⁰

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.³¹

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.³²

15.4 Reasons for final decision

Our reasons for our final decisions on Powercor's proposed pass through events are set out below.

15.4.1 Insurance cap event

We accept the inclusion of an insurance cap event. While we have not adopted Powercor's definition in its entirety, we have modified our definition in response to its submission on our preliminary decision.

Our preliminary decision defined the insurance cap as the greater of (a) the regulated entity's actual policy level, and (b) the policy limit that is explicitly or implicitly commensurate with the allowance for insurance premiums that is included in the forecast operating expenditure allowance approved in the distribution determination. The second limb was included to avoid a perverse incentive for an NSP to reduce its expenditure on insurance below prudent efficient levels, thereby reducing its operating expenditure relative to the approved forecast, by transferring insurable risks to its customers instead of through genuine efficiencies.

Powercor objected that the relevant policy limit should not be defined by reference to its approved operating expenditure on the basis that:

²⁸ AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, pp. 19–20.

²⁹ AEMC, *Economic Regulation of Network Service Providers, and Price and Revenue Regulation of Gas Services, Final Position Paper*, 29 November 2012, Sydney, p. 186.

³⁰ NER, Chapter 10: Glossary, definition of 'materially'.

³¹ 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.

³² NER, cl. S6.2.1(e)(1)(ii).

- this limb is very uncertain in meaning and effect, as it is impossible to ascertain the allowance for insurance premiums in its approved operating expenditure
- no conclusions were reached as to the efficient and prudent level of insurance when determining Powercor's forecast operating expenditure for the Preliminary Determination
- the amendments are unnecessary, since the policy objectives are met through clauses 6.6.1(j) (3) and (7) of the NER (which require consideration of the efficiency of the DNSP's actions as well as whether the costs are already factored into the revenue requirement).³³

We maintain that the insurance cap event should operate so as to dissuade a regulated firm from reducing its cover below prudent and efficient levels. However, we have considered Powercor's arguments as well as submissions in concurrent regulatory processes.³⁴ We accept that a firm's approved operating expenditure may not imply a particular level of insurance cover, and have removed this limb from the definition. However, it remains appropriate that we take into account where relevant, any assessments and analysis we have undertaken in relation to insurance when approving the service provider's distribution determination. We have added a note to this effect stating that, when making a determination on a pass through application, we will have regard to:

- (iii) any assessment by the AER of Powercor's insurance in approving the access arrangement for the relevant period.

We consulted Powercor on the final form of this definition and it did not comment on this change.³⁵

15.4.2 Insurer credit risk event

We accept the inclusion of an insurer credit risk event, and we have adopted the definition in Powercor's revised regulatory proposal.

Our preliminary decision amended Powercor's proposed definition so as to:

- disallow the pass through of costs associated with changes to insurance premiums as a result of an insurer becoming insolvent
- confine pass through to costs specific to existing or potential claims against the failed insurer, rather than insurance generally as the result of the insolvency of an insurer

³³ Powercor, *Revised Regulatory Proposal 2016-20*, January 2016, pp. 412–413.

³⁴ ActewAGL Distribution, *Response to AER's draft determination, 2016-21 ACT, Queanbeyan and Palerang Gas Network Access Arrangement*, January 2016, p. 125; CitiPower, *Revised Regulatory Proposal 2016-2020*, January 2016, pp. 420–421.

³⁵ Powercor, Response to information request 52 [email to AER], 29 March 2016.

- identify factors which we will have regard to in making a determination on a pass through application.³⁶

Powercor's revised regulatory proposal accepted our definition except for an amendment to delete the word 'nominated' from the term 'nominated insurer of Powercor', on the basis that:

[Powercor] consider[s] that the meaning of 'nominated insurer' is unclear and as such introduces uncertainty into the definition of the insurer credit risk event.³⁷

We accept that the word 'nominated' is redundant and have removed it from the definition.

15.4.3 Natural disaster event

We accept the inclusion of natural disaster event. We have also largely accepted the definition in Powercor's revised regulatory proposal subject to the refinements detailed below.

Our preliminary decision accepted the inclusion of a natural disaster event but did not accept Powercor's proposed definition. Our modified definition was:³⁸

A natural disaster event occurs if:

Any major fire, flood, earthquake or other natural disaster occurs during the 2016–20 regulatory control period and materially increases the costs to Powercor in providing direct control services, provided the fire, flood or other event was not a consequence of the acts or omissions of the service provider.

The term 'major' in the above paragraph means an event that is serious and significant. It does not mean material as that term is defined in the Rules (that is 1 per cent of the DNSP's annual revenue requirement for that regulatory year).

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

- i. whether Powercor has insurance against the event,
- ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event,
- iii. whether a relevant government authority has made a declaration that a natural disaster has occurred.

³⁶ AER, *Preliminary Decision, Powercor Distribution Determination 2016 to 2020, Attachment 15 Pass Through Events*, October 2015, p. 15-16 to 15-17.

³⁷ Powercor, *Revised Regulatory Proposal 2016-20*, January 2016, pp. 414–415.

³⁸ AER, *Preliminary Decision, Powercor Distribution Determination 2016 to 2020, Attachment 15 Pass Through Events*, October 2015, p. 15-19.

In its revised proposal Powercor incorporated all but one element of this definition. It submitted that consideration of whether a relevant government authority has made a declaration that a natural disaster has occurred would create uncertainty. Such a declaration would be concerned with the impact on the community and its citizens and not with the impact on a network business. While not accepting a declaration would be irrelevant or create uncertainty, we are satisfied it is unnecessary to refer explicitly to whether a government authority has declared an event to be a natural disaster and have accordingly removed it from the definition. The definition of natural disaster event approved in this final decision will provide a sufficient basis for us to make a determination under rule 6.6.1 as to whether such an event has occurred, and accept this element of Powercor's proposal.

While not an issue raised in Powercor's revised proposal, in our final decisions on concurrent proposals for other service providers, we have removed the adjectives 'major' and 'materially' from the definition of the natural disaster event to avoid perceived confusion with the materiality threshold that applies to all pass through events under the NER. We put these changes to Powercor for the purposes of our final decision on its proposal, and it responded that it had no comments.³⁹

15.4.4 Terrorism event

We accept the inclusion of a terrorism event. We also largely accept the definition in Powercor's revised regulatory proposal, with the exception of the cyber-terrorism element and subject to the refinements detailed below.

Our preliminary decision allowed a terrorism event but did not accept Powercor's proposed definition. Our alternative definition was:⁴⁰

A terrorism event occurs if:

An act (including, but not limited to, the use of force or violence or the threat of force or violence) of any person or group of persons (whether acting alone or on behalf of or in connection with any organisation or government), which from its nature or context is done for, or in connection with, political, religious, ideological, ethnic or similar purposes or reasons (including the intention to influence or intimidate any government and/or put the public, or any section of the public, in fear) and which materially increases the costs to Powercor in providing direct control services.

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

- i. whether Powercor has insurance against the event,

³⁹ Powercor, response to information request 52 [email to AER], 29 March 2016.

⁴⁰ AER, *Preliminary Decision, Powercor Distribution Determination 2016 to 2020 - Attachment 15 Pass Through Events*, October 2015, p. 15-21.

- 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.

Powercor's revised proposal incorporated this definition in part, but differed in two respects (underlined):

A terrorism event occurs if:

An act (including, but not limited to, the use of force or violence, the threat of force or violence, attacks or other disruptive activities against, or the deliberate introduction of harmful code or viruses to, computer systems, computer networks, data and/or communication systems, or the threat of such attacks or disruptive activities, or of the deliberate introduction of such harmful code or viruses) of any person or group of persons (whether acting alone or on behalf of or in connection with any organisation or government), which from its nature or context is done for, or in connection with, political, religious, ideological, ethnic or similar purposes or reasons (including the intention to influence or intimidate any government and/or put the public, or any section of the public, in fear) and which materially increases the costs to Powercor in providing direct control services.

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

- i. whether Powercor has insurance against the event, and
- 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.~~

Our preliminary decision rejected Powercor's proposal to add cyber-terrorism to the examples of what might constitute an act of terrorism. This reflected our view that such attacks, including the introduction of harmful code or viruses, should be managed through prudent and efficient IT protection. We expressed concern that allowing cyber-terrorism costs to be passed through may act as a disincentive to effect management of this risk.⁴¹

Powercor did not make this amendment, arguing that a cyber-related attack could occur despite it having taken prudent and efficient actions in accordance with good industry practice. It argued that—having accepted that our preferred definition would cover events appropriately characterised as cyber-terrorism—we were incorrect in

⁴¹ AER, *Preliminary Decision, Powercor Distribution Determination 2016 to 2020 - Attachment 15 Pass Through Events*, October 2015, p. 15-20.

finding that its explicit inclusion would lower incentives to manage this risk. Powercor also noted our ability, under rule 6.6.1(j) to take the efficiency and prudence of its actions into account in determining an approved pass through amount.⁴² We accept Powercor's submission that a cyber-related attack could occur despite prudent protection measures. Accordingly, if a cyber-attack has the characteristics of an act of terrorism, then Powercor could apply to have those costs passed through. However, we do not believe it is necessary to include a description of cyber-terrorism in the definition of terrorist event.

Powercor also submitted that consideration of whether a relevant government authority has made a declaration that a terrorism event has occurred would create uncertainty. It noted in particular uncertainty as to what 'relevant government' means, the different criteria that various government authorities may apply and the impact political sensitivities may have on a decision to declare a terrorism event.⁴³ We disagree. A declaration or otherwise is not determinative of whether an occurrence is within the scope of the terrorism event. It may not be straightforward to distinguish between an act of terrorism and a bare crime, particularly since the motivation and intent of the perpetrators are key elements. As such, we are justified in having regard to the deliberations of government authorities with responsibilities and expertise in this field.

While not an issue raised in Powercor's revised proposal, in our final decisions on concurrent proposals for other Victorian DNSPs, we have removed the adjective 'materially' from the definition of the terrorism event to avoid perceived confusion with the materiality threshold that applies to all pass through events under the NER. We put this to Powercor for the purposes of our final decision on its proposal, and it responded that it had no comments.⁴⁴

15.4.5 Retailer insolvency event

We accept the retailer insolvency pass through event nominated in Powercor's revised proposal, with one modification to the definition.

Retailer insolvency is a category of prescribed pass through event under the NER,⁴⁵ which defines it as:

The failure of a retailer during a regulatory control period, to pay a Distribution Network Service Provider an amount to which the service provider is entitled for the provision of direct control services, if:

- (a) an insolvency official has been appointed in respect of that retailer; and

⁴² Powercor, *Revised Regulatory Proposal 2016-20*, January 2016, pp. 418–419.

⁴³ Powercor, *Revised Regulatory Proposal 2016-20*, January 2016, p. 419.

⁴⁴ Powercor, response to information request 52 [email to AER], 29 March 2016.

⁴⁵ NER, cl. 6.6.1(a1).

(b) the Distribution Network Service Provider is not entitled to payment of that amount in full under the terms of any credit support provided in respect of that retailer.

The prescribed event is not available to Victorian NSPs. Powercor therefore submitted that a *nominated* retailer insolvency pass through event should be accepted:

Similar to distributors in jurisdictions which have implemented NECF, we are unable to manage the risk of retailers defaulting on payment of their network charges. Given the uncertainty of the application of the retailer insolvency event in Victoria, we seek the AER to include this event as a nominated pass through event in our distribution determination.⁴⁶

Our draft decision accepted the inclusion of a nominated pass through event for retailer insolvency, but modified the definition because of uncertainty around the NER definition due to a rule change proposal being considered by the AEMC. Our preliminary decision definition was:

Prior to the commencement of the National Energy Customer Framework in Victoria, retailer insolvency event has the meaning set out in the NER as in force from time to time.

Note: This retailer insolvency event will cease to apply as a nominated pass through event on commencement of the National Energy Customer Framework in Victoria.

In response to our draft decision Powercor proposed an alternative definition, which it considered would:⁴⁷

- provide for the circumstance where terms used in the retailer insolvency event in the NER are defined by reference to provisions of the NER or National Energy Retail Law which are not in effect in Victoria
- provide that the terms 'eligible pass through amount' and 'positive change event' where they appear in the NER are modified in respect of its nominated retailer insolvency event in the same manner as they are modified in respect of the prescribed retailer insolvency event in the NER from time to time.

Powercor proposed the following modifications (underlined):⁴⁸

Until such time as the National Energy Retail Law set out in the Schedule to the National Energy Retail Law (South Australia) Act 2011 of South Australia is applied as a law of Victoria, retailer insolvency event has the meaning set out in the NER as in force from time to time, except that:

⁴⁷ Powercor, *Revised Regulatory Proposal 2016-20*, January 2016, p. 424.

⁴⁸ Powercor, *Revised Regulatory Proposal 2016-20*, January 2016, p. 422.

(a) where used in the definition of 'retailer insolvency event' in the NER, the term 'retailer' means the holder of a licence to sell electricity under the Electricity Industry Act 2000 (Vic) or an exemption from the requirement to hold a licence to sell electricity under that Act; and

(b) other terms used in the definition of retailer insolvency event in the Rules as a consequence of amendments made to that definition from time to time, which would otherwise take their meaning by reference to provisions of the NER or National Energy Retail Law not in force in Victoria, take their ordinary meaning and natural meaning, or their technical meaning (as the case may be).

For the purposes of this definition, the terms 'eligible pass through amount' and 'positive change event' where they appear in the NER are modified in respect of this retailer insolvency event in the same manner as those terms are modified in respect of the retailer insolvency event prescribed in the NER from time to time.

Note: This retailer insolvency event will cease to apply as a nominated pass through event on commencement of the National Energy Customer Framework⁴⁹ in Victoria.⁵⁰

We accept each of these amendments except for the reference to exempt retailers in paragraph (a). The first and last of the amendments clarify our original intent, while paragraph (b) deals with the possibility that future amendments to the NER prescribed event may introduce terms not defined in applicable (Victorian or national) energy law.

However, we consider including exempt retailers in paragraph (a) would not achieve the objective of aligning the nominated retailer insolvency event with the corresponding event prescribed in the NER.⁵¹ A 'retailer', for the purposes of the NER event "means a person who is the holder of a retailer authorisation issued under the NER in respect of the sale of electricity". It does not include a person who is exempt from the requirement to hold a retailer authorisation, as contemplated by proposed sub-clause (a). This narrower definition is also consistent with the definition of 'retailer' in Victoria's Electricity Industry Act:⁵²

retailer means the holder of a licence to sell electricity otherwise than through the wholesale electricity market;

We consulted with Powercor on the final form of this definition and it confirmed its preference for the definition to retain reference to entities exempt from holding a licence to sell electricity, noting it currently does supply such customers. However, we have excluded the reference to exempt retailers from the definition of retailer insolvency event for the reasons in the foregoing paragraphs.

⁴⁹ In the Note to the definition, PowerCor referred to the National Energy Customer Framework, which was referred to in the Note to the draft decision definition. We have since amended this to 'National Energy Retail Law'.

⁵⁰ Powercor, *Revised Regulatory Proposal 2016-20*, January 2016, pp. 422–423.

⁵¹ NER, cl. 6.6.1(a1).

⁵² *Electricity Industry Act 2000* (Vic), s. 3.