

Cost pass through application – October 2021 storm

10 March 2022

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1 Executive summary

This application seeks Australian Energy Regulator (AER) approval to pass through to customers the additional costs we incurred to respond to and remedy the damage caused to our distribution network following the 29 October 2021 storm (October Storm).¹

The October Storm affected a significant geographic area, including Melbourne's south eastern suburbs and the Mornington Peninsula, and impacted our ability to provide direct control services. It is the relevant event upon which this pass through application is based.

Figure 1: Storm damage



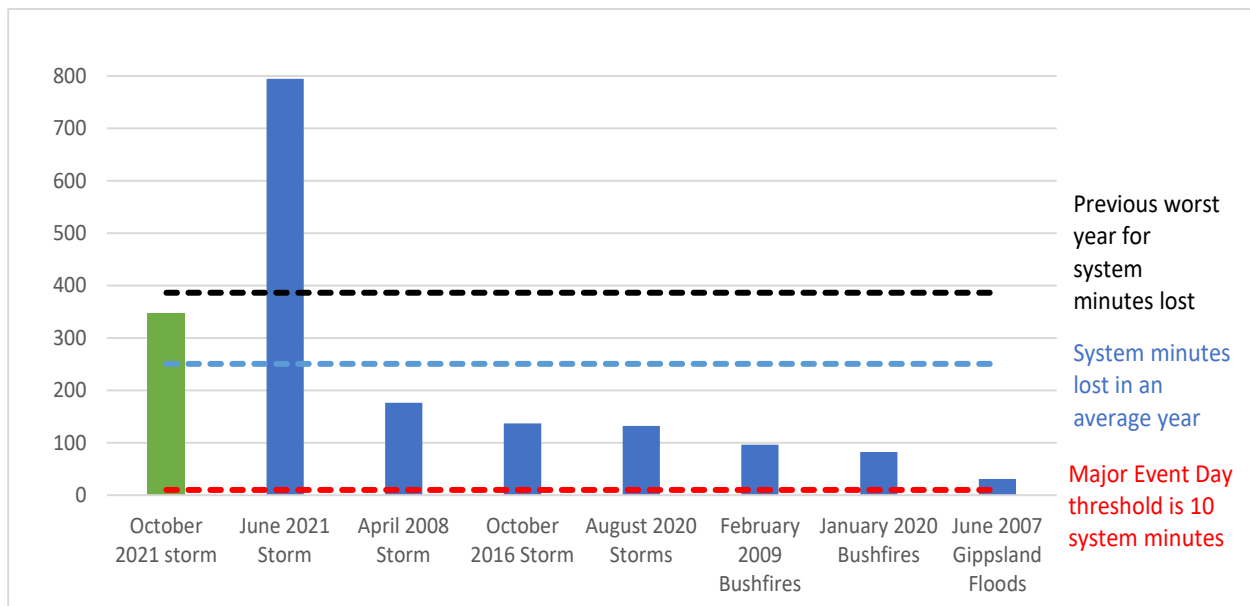
Source:

<https://feedback.facebook.com/AusNet.Services.Energy/photos/pcb.1482386665457928/1482386562124605/?type=3&theater>
(accessed 21/12/2021).

The October Storm resulted in 230,000 customers being off supply (although most of the affected customers had their power back on by the end of 5 November 2021). The severity of the storm damaged our assets and/or caused damage through trees/other debris hitting our power lines.

The severity of the storm is demonstrated by the chart below which shows the impact relative to previous large events, including the recent 9 and 10 June 2021 storms.^{2, 3}

¹ Pursuant to clause 6.6.1(a) of the National Electricity Rules (NER).

Figure 3: System minutes lost

Source: AusNet

Damaging north westerly winds, averaging 50 to 70 km/h with peak gusts of 90 to 100 km/h, were experienced across eastern parts of Victoria, with gusts reaching 100 to 120 km/h about the higher peaks of the Alpine area. Similarly, damaging south westerly winds, averaging 60 to 70 km/h with gusts of 90 to 110 km/h, were experienced over Gippsland from the west, with peak gusts reaching around 120 km/h about the Bass Coast.

Importantly, our crews entered the affected areas as soon as it was safe to do so, with the aim of restoring energy supply as quickly and as safely as possible.

Additional costs incurred

Our response to the October Storm resulted in us incurring \$9.8 million (\$2021) in additional costs that were not allowed for in the 2021-26 distribution determination. This additional expenditure is material and has impacted the cost of us providing direct control services. We are, therefore, seeking recovery of these additional costs via the cost pass through provisions of the National Electricity Rules (NER).⁴

We consider that our \$5.7 million (\$2021, smoothed) positive pass through amount should be approved as:

- The October Storm meets the relevant requirements to qualify as a natural disaster pass through event, which was approved by the AER as a nominated pass through event in our 2021-26 distribution determination.
- The costs incurred as a result of the October Storm satisfy the 1% materiality threshold in the NER for the pass through event to be a positive change event.

² The magnitude of the 9 and 10 June 2021 Storms resulted in us submitting a cost pass through application to the AER. See: <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/cost-pass-throughs/ausnet-services-%E2%80%93-cost-pass-through-2020-21-storms-natural-disaster> (accessed 20/12/2021). The AER's decision on that application is still pending.

³ Relative to the June Storms, the damage caused by the October Storm was not as severe, but it did impact a significantly larger geographic area.

⁴ See clause 6.6.1.

- Our application addresses each of the requirements outlined in clause 6.6.1(c).⁵
- Our application was submitted on or prior to 11 March 2022, being 90 business days of the relevant positive change event occurring (in accordance with clause 6.6.1(c)).

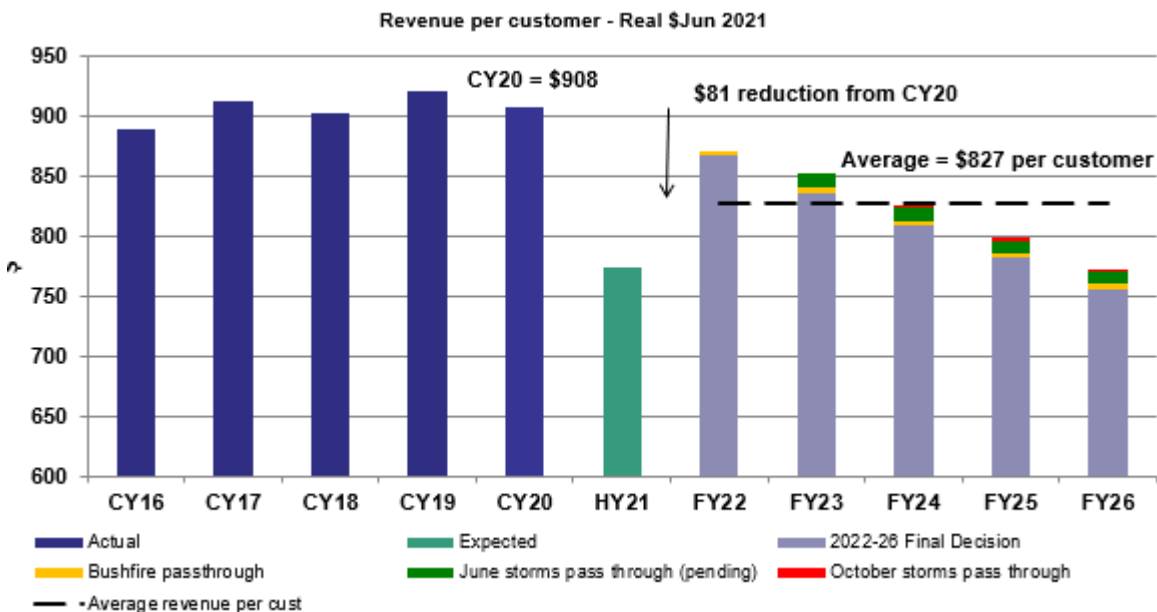
We have also proposed an expenditure decrement of \$0.1 million (\$2021) in future years to account for future work that was brought forward to the storm recovery period, and which no longer requires the funding approved in our 2021-2026 distribution determination.

Recovery period

We are proposing that this positive pass through amount be recovered in equal amounts (in nominal terms) over a 3-year period starting 1 July 2023 and ending on 30 June 2026. Given we are expecting prices to fall, this recovery profile will help smooth the resultant price increase over the current regulatory period.⁶

As shown in the figure below, the pass through amount will contribute around \$2.30 to the average customer’s bill each year of the 3 year period starting from 1 July 2023.

Figure 4: Revenue per customer (real \$2021)



Source: AusNet

Note: We have experienced continued strong customer growth despite the impact of COVID-19. Relative to the EDPR we have, therefore, used higher customer number data to prepare this chart.

2 Cost pass through framework

The pass through provisions in Chapter 6 of the NER allow Distribution Network Service Providers (DNSPs) to seek approval from the AER to recover (by passing through to customers)

⁵ This application also addresses the matters listed in clause 6.6.1(j) that the AER must take into account in determining the approved pass through amounts. This will enable the AER to approve the costs we have proposed as part of this positive pass through amount.

⁶ The material presented in Figure 4 captures the impact of our June 2021 Storms cost pass through application. While the result of that application is pending, we have included this information for completeness.

a material increase in the costs of providing direct control services where the increase is the result of an event specified in clause 6.6.1.(a1).

2.1 Our written statement

To seek approval from the AER to pass through those costs, the NER require a DNSP to submit a written statement to the AER within 90 business days of the relevant positive change event occurring⁷, or such longer period as agreed to by the AER in accordance with clause 6.6.1(k). The written statement must address the matters outlined in clause 6.6.1(c), namely:

- The details of the positive change event.
- The date on which the positive change event occurred.
- The eligible pass through amount in respect of the positive change event.
- The positive pass through amount we are proposing in relation to the positive change event.
- The amount of the positive pass through amount that we propose should be passed through to distribution network users in the regulatory year in which, and each regulatory year after that in which, the positive change event occurred.
- Evidence:⁸
 - of the actual and likely increase in costs referred to in clause 6.6.1(c)(3) of the Rules; and
 - that such costs occur solely as a consequence of the positive change event.
- Such other information as may be required under any relevant regulatory information instrument.

2.2 Framework for AER assessment

If the AER determines that a positive change event has occurred, it must determine:

- the approved pass through amount; and
- the amount of the approved pass through amount that should be passed through to distribution network users in the regulatory year in which, and each regulatory year after that in which, the positive change event occurred.

In making this decision, the AER must consider the factors listed in clause 6.6.1(j) of the NER.

In addition, the National Electricity Law (NEL) requires the AER, in exercising its economic regulatory functions and powers, to do so in a manner that will or is likely to contribute to the achievement of the National Electricity Objective (NEO).

The NEL also specifies the revenue and pricing principles.⁹ Of relevance to this application is the principle that a regulated network service provider should be provided with a reasonable opportunity to recover at least the efficient costs the operator incurs in providing direct control services and complying with a regulatory obligation or requirement or making a regulatory payment.¹⁰

⁷ Clause 6.6.1(c).

⁸ We have not recited clause 6.6.1(c)(6)(iii) as it relates to a retailer insolvency event and is not applicable.

⁹ Section 7A.

¹⁰ National Electricity Law, section 7A(2).

3 Outline of our written statement

This application¹¹, comprising this document and its attachments, is our written statement to the AER¹² to recover a positive pass through amount of \$5.7 million (\$2021, smoothed). It complies with the requirements of clause 6.6.1(c) of the NER as it provides:

- the relevant details to enable the AER to determine that a positive change event has occurred;
- the details of the eligible pass through amount;
- the positive pass through amount; and
- evidence of the increase in costs.

This application also addresses the matters listed in clause 6.6.1(j) of the NER which the AER must take into account in deciding the approved pass through amounts.¹³

This application was submitted to the AER on or before 11 March 2022, being within 90 business days of the relevant positive change event occurring in accordance with NER clause 6.6.1(c). Therefore, the requirement to submit the written statement by the requisite date is satisfied.

Our application addresses the remaining matters in the following sections:

- **Section 4: Positive change event** – demonstrates why the October Storm satisfy the definition of a positive change event.
- **Section 5: Cost incurred** – outlines the additional costs we incurred in providing direct control services as the result of the October Storm. These costs capture the activities we undertook to address the impact of the storm and restore our network. Further evidence to support the costs that were incurred because of the October Storm is provided in Attachment 1.
- **Section 6: Pass through amount** – specifies the eligible pass through amount and positive pass through amount in relation to the October Storm.
- **Section 7: Service Target Performance Incentive Scheme (STPIS)** – outlines why the October Storm should be excluded from the calculation of the STPIS, an incentive scheme that aims to rewards/penalise us for managing network reliability for factors within our control.

As part of our application we have also provided:

- A compliance checklist that identifies the sections of our written statement that address the NER requirements for a pass through application (Attachment 2).
- A non-confidential version of this written statement to facilitate public consultation and a confidentiality template (Attachments 3 and 4) in accordance with the AER's confidentiality guidelines.

¹¹ At times referred to in this document as 'statement' or 'application'. These terms should be read interchangeably and inclusive of all appendices and supporting attachments accompanying this application.

¹² See clause 6.6.1(c) of the NER.

¹³ We note clause 6.6.1(c)(7) requires us to provide such other information as may be required under any relevant regulatory information instrument. No such instrument has been issued by the AER at the time of submitting this statement. However, clause 6.6.1(e1) provides scope for the AER to request additional information to help it make its determination. We will welcome any such engagement if it will assist the AER in its deliberations.

4 Positive change event

4.1 The October Storm as a pass through event

To be eligible for a pass through application we must establish that a positive change event has occurred. A positive change event is:

... a pass through event ... which entails the Distribution Network Service Provider incurring materially higher costs in providing direct control services than it would have incurred but for the event, but does not include a contingent project or an associated trigger event.¹⁴

The positive change event that is the subject of this application is the severe storm that began on 29 October 2021, which severely impacted our network and our customers. We have used 29 October 2021 as the date on which a positive change event occurred.

The remainder of this section, in conjunction with the materiality assessment in section 5.3, demonstrates how the October Storm event meets the requirements of a positive change event, namely that:

- 1) it is a pass through event;
- 2) materially higher costs were incurred in providing direct control services; and
- 3) the event is not a contingent project or an associated trigger event.

A 'pass through event' means, for a distribution determination, an event specified in clause 6.6.1(a1).¹⁵ The clause specifies that each of the following are a pass through event:

- 1) a regulatory change event;
- 2) a service standard event;
- 3) a tax change event;
- 4) a retailer insolvency event¹⁶; and
- 5) any other event specified in a distribution determination as a pass-through event for the determination.

This application is in respect of a nominated pass through event under clause 6.6.1 (a1)(5).

The relevant distribution determination during which the October Storm occurred is our 2021-26 determination.¹⁷ The AER's Final Decision confirmed that a 'natural disaster event' will apply to as a nominated pass through event for the 2021–26 regulatory period. A 'natural disaster event' is defined as:

... any natural disaster including but not limited to cyclone, fire, flood or earthquake that occurs during the 2021–26 regulatory control period that changes the costs to AusNet Services in providing direct control services, provided the cyclone, fire, flood, earthquake or other event ...¹⁸

¹⁴ NER, Chapter 10 (definition of 'positive change event').

¹⁵ NER, cl 6.6.1(a1) and Chapter 10 (definition of 'pass through event').

¹⁶ This event definition is not applicable in Victoria as Victoria is not a NECF jurisdiction.

¹⁷ Available at: <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/ausnet-services-determination-2021-26/final-decision> (accessed 20/12/2021).

¹⁸ AER, AusNet Services distribution determination final decision 2021–26, Attachment 15 – Pass through events, pp. 15-17 to 15-18.

The definition includes a note to the effect that in assessing a pass through application for a natural disaster event, the AER will have regard to, amongst other things, whether we have insurance against the event and the level of insurance that an efficient and prudent NSP would obtain in respect of the event. These matters are addressed in this application.

This application demonstrates that these costs are properly part of the eligible pass through amount associated with the October Storm, and that we are permitted to pass through these costs to distribution network users. Specifically:

- Section 4.2 demonstrates that the October Storm event constitutes a positive change event as it was a 'natural disaster', in the normal meaning of the phrase, and not a consequence of our acts or omissions.
- The event is not a contingent project or trigger event, for the reasons discussed in section 4.3; and
- The October Storm event resulted in us incurring materially higher costs in providing direct control services for the reasons discussed in section 5.3.

4.2 Details of the event

The October Storm caused widespread damage throughout parts of Victoria and heavily impacted our network.

Figure 5: Damage to the network



Source:

<https://feedback.facebook.com/AusNet.Services.Energy/photos/pcb.1483600712003190/1483599005336694/?type=3&theater> (accessed 21/12/2021).

At times, wind gusts exceeded 100 km/h. The extreme weather resulted in flooding, fallen trees and poles, and damage to overhead power lines. At its peak, 230,000 customers or around 30% of our total customer base, were without power.¹⁹

As a result of the storm, the Victoria State Emergency Service (VICSES) noted that it had received thousands of calls for help.²⁰

¹⁹ Using SAIFI (customer interruptions) data would suggest more customers were affected by the October Storms. We have used the peak number to avoid customer who experienced multiple interruptions during the October Storms being captured multiple times.

²⁰ Victoria State of Emergency Services, VICSES receives thousands of calls for help following storm event, available at: <https://www.ses.vic.gov.au/w/thousands-of-calls?redirect=%2F> (accessed 20/12/2021).

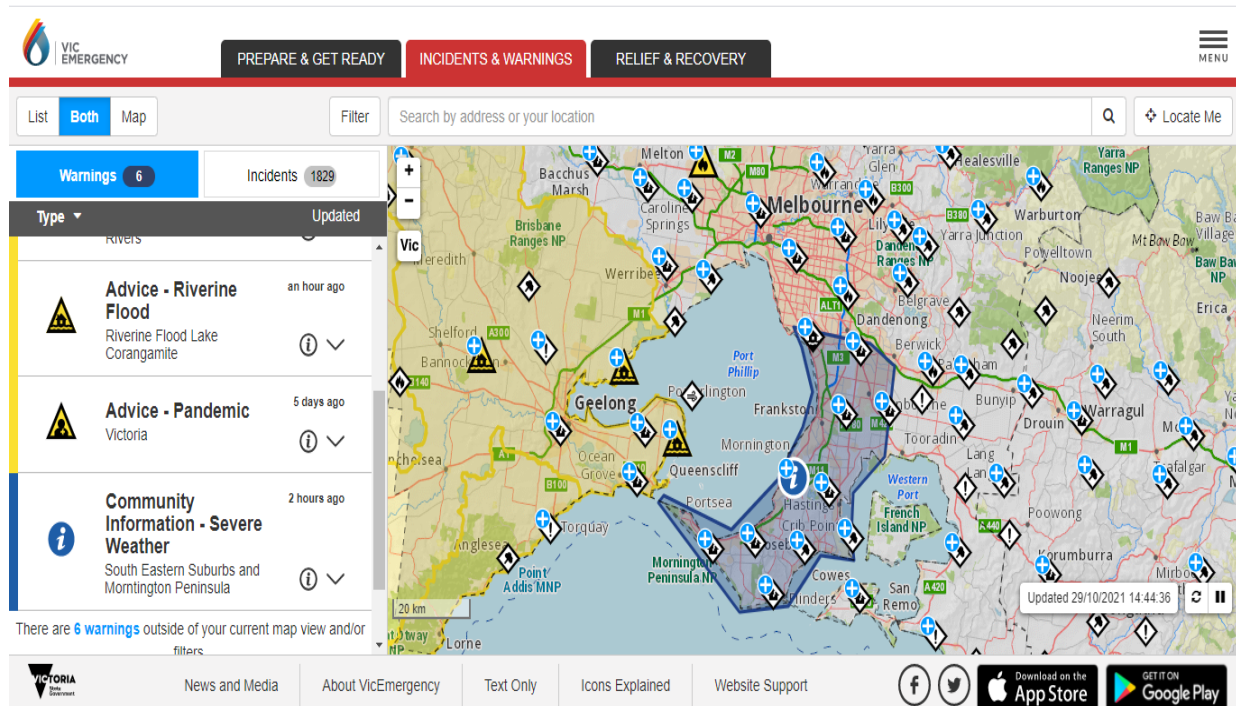
Figure 7: State Emergency Services assistance



Source: SES Nillumbik Unit - <https://feedback.facebook.com/photo.php?fbid=242073081288305&set=pcb.242074087954871&type=3&theater> (accessed 21/12/2021)

The extent of the damage was extensive, and a screenshot from the Vic emergency website shows this (see the figure below).

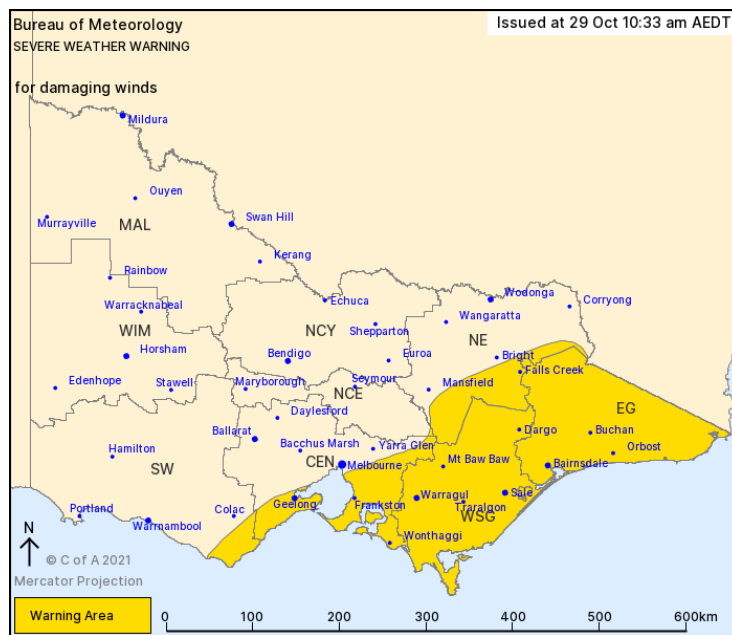
Figure 8: Severe weather warning



Source: <https://www.emergency.vic.gov.au/respond/#> (accessed 29/10/2021)

The Bureau of Meteorology (BOM) also issued weather warnings (see below) and subsequently noted the severe weather conditions that many of our customers were facing in the Melbourne October 2021 monthly statements and the Monthly Weather Review Australia October 2021.²¹

²¹ See: <http://www.bom.gov.au/climate/current/month/vic/archive/202110.melbourne.shtml> (accessed 20/12/21) and http://www.bom.gov.au/clim_data/IDCKGC1AR0/202110.summary.shtml (accessed 20/12/21).

Figure 9: Bureau of Meteorology weather warning (29 October 2021)

Source: Bureau of Meteorology

A range of other sources, including the Insurance Council of Australia, have also highlighted the severe impact of the October Storm.²²

Crisis management

Central to the effectiveness of our response to the October Storm was our ability to activate appropriate emergency response protocols. Used across emergency services organisations, the Strategic Plan for Integrated Response and Contingency System (SPIRACS) is a highly developed response system, that escalates incidents to different layers of management according to severity. The purpose of this system is to:

- Ensure the outcomes of an emergency are managed and planned.
- Control events which may interrupt a safe supply.
- Prepare for those events which are not preventable.
- Respond to those events which impact the business.
- Recover from events.

Our staff – and our delivery partner staff, who participate in emergency response activities upon escalation from business as usual (BAU) operations – are trained in the escalation procedures and participate in trial scenarios so that roles and decision-making processes are well understood. This facilitates the effectiveness of response to the incident.

In response to predicted storm activity (including severe BOM Severe Weather Alert for Damaging Winds), relevant teams were communicated with as early as 15 October 2021 to inform them to start review resourcing and planning for a high activity day on 29 October. As the 29 October Storm took hold, we quickly determined that we were dealing with a natural disaster

²² See, for example: <https://insurancecouncil.com.au/resource/insurance-catastrophe-extended-to-include-victoria-and-tasmania/> and <https://insurancecouncil.com.au/wp-content/uploads/2021/11/211101-Insurance-Catastrophe-extended-to-include-Vic-and-Tas.pdf>; <https://www.insurancebusinessmag.com.au/news/natural-catastrophe/suncorp-releases-claims-update-for-october-storms-315549.aspx>; <https://www.reinsurancene.ws/october-storms-cause-iag-to-tap-reinsurance-raise-fy-loss-forecast/> and <https://www.afca.org.au/news/significant-events/sa-victoria-and-tasmania-severe-storms-october-2021> (all accessed 20/12/21).

with a Level 4 escalation. This meant that an Emergency Management Team (EMT) & Crisis Management Team (CMT) were immediately established.²³ In addition, the Victorian Electricity Emergency Communication Protocol (VEECP) was activated via AEMO.

Our preparation and successful implementation of our (SPIRACS) response helped us to navigate the aftermath of the storm and ensure our customers were supported and were back on supply as soon as it was safe to do so.

Further information on the SPIRACS escalation process is at Attachment 5.

Incident response

As the severity of the storm became apparent, it was essential for us to remain alert to the network elements at risk, and to be at the ready to conduct inspections of assets and to restore service continuity as soon as it was safe to do so. From the beginning of the storm event we implemented steps to keep customers affected or at risk informed on our activities.

Further information on some of the steps that we took from very early in the process are outlined below:

- Leading up to the storm we held preparatory emergency management meetings about the upcoming storm. We were, therefore, in a state of readiness for heightened network activity when the storm hit.
- Widespread damage was evident across our network on 29 October 2021. However, the full extent of the restoration task was not immediately known as the storm was still passing through our network and causing access issues.
- Planned work was cancelled (as were new connections) and, in conjunction with our resource partner, we started to work through our restoration plans, including which areas we were going to commence our restoration work. Restoration work commenced on 29 October 2021.
- Despite difficult weather, aerial assessments were undertaken as soon as it was safe to do so. Aerial support is an expedient way to conduct patrols and to identify the maximum number of restoration options.
- To support the recovery effort, ariel, field and vegetation management strike teams were established (all of which will help the timely addressing of faults and the restoration of supply).
- High inbound call volumes were addressed, and updates were provided on social media. SMS and customised messages were also sent, including with respect to estimated restoration times (a key concern for many of our customers). While we briefed the media through-out this event, AEMO was (early in the process) confirmed as the Single Industry Spokesperson. This meant that it provided regular information on the total number of outages across each network and the details for the different media contacts.²⁴
- Regularly engaged the Victorian Government, including on communities likely to be offline for more than 72 hours and who needed Government support. Throughout and after the event we also continued our correspondence with Government MPs.
- Most affected customers had their power restored by 5 November 2021 (if not sooner). However, a small number of customers that were spread across a significant geographic area experienced slightly longer delays.

²³ The EMT held meetings on this event up to and including 8 November 2011.

²⁴ AEMO stood down from performing this role on 30 October but was to continue to provide updates around lunchtime each day.

4.3 Exclusion of contingent projects and trigger events

A pass through event must not be a contingent project or an associated trigger event.

A contingent project is a contingent project proposed by the DNSP that is approved by the AER in accordance with clause 6.6A.1(b). A trigger event is a specific condition or event described in clause 6.6A.1(c), the occurrence of which, during the relevant regulatory period, may result in the amendment of a distribution determination under clause 6.6A.2.

The AER's Final Decision for our 2021-26 regulatory period did not include any contingent project programs. As such, we did not propose, and the AER did not approve a contingent project for capital expenditure of the kind required by the response to the October Storm. Therefore, the October Storm is not precluded from being a positive pass through event.

5 Costs incurred

Another of the thresholds that must be satisfied for the AER to approve a positive pass through application is that the cost to the DNSP of providing direct control services must increase "materially" as a result of the pass through event.

An increase in costs is material if the change in costs (as opposed to the revenue impact) that a DNSP has incurred, and is likely to incur, in any year of a regulatory period, as a result of the event, exceeds 1% of the annual revenue requirement for the DNSP for that regulatory year.²⁵

5.1 Material change in the costs of providing direct control services

Restoring powerlines in the storm-affected areas and ensuring safe operation has resulted in a significant increase in costs to provide direct control services to customers in the regions affected by the October Storm. The following sections demonstrate that the increase in costs attributable to carrying out relevant activities meets the materiality threshold.

It is noted that a proportion of the increased costs were incurred directly by us, whereas others were passed on to us by third party contractors engaged to perform the work on our behalf. For the costs that were incurred by third party contractors, we have carefully assessed all claims put forward and have also had those claims reviewed by independent experts. This process was robust and several efficiencies were identified as a result.

As part of this process we have also identified the expected cost reductions in the 2021-26 regulatory period. These cost reductions reflect the fact that some work that would have been required in future years and is part of the on-going cost of maintaining the network, was brought forward and carried out as a necessary part of the storm restoration activities.

Initial inspection

The first activity in the recovery effort was to patrol the affected distribution lines to ascertain the extent of the asset damage. This is a critical first step field response, as it also enables an assessment of the relative difficulty in restoring customers' electricity supply. This work was conducted as soon as it was safe to do so. The costs we incurred during this initial inspection phase include timesheet costs for asset inspectors, helicopter hire for aerial inspections and fuel costs for vehicles.

²⁵ Definition of "materially", chapter 10 of the National Electricity Rules.

Consistent with the approach we adopted for the June 2021 Storms, we established cost codes for each of our business units to capture the (incremental) cost we incurred as part of the storm recovery effort. Costs involved include timesheet costs for asset inspectors, aerial inspections and fuel costs for vehicles. Timesheet costs included normal time work, work undertaken by volunteers to support the storm recovery effort and overtime and week-end work. There were also costs for office-based activities such as project management and administration in coordinating the event response.

Vegetation management

Our network covers areas that are heavily treed and the vegetation damaged by the storm impacted the network by falling across and/or damaging our lines. Removing these hazards was a high priority and a pre-condition to being able to restore services safely.

Restoration of supply

Once safe access was obtained, we helped co-ordinate the Victorian Government's roll-out of temporary solutions. We also rolled-out some mobile generators to some key sites.²⁶ Where it was not possible for us to restore supply via the grid quickly, restoration activities remained a top priority.

Figure 10: Restoring supply



Source: AusNet
(<https://feedback.facebook.com/AusNet.Services.Energy/photos/pcb.1482245768805351/1482245668805361/?type=3&theater>)

²⁶ For example, generators were arranged at emergency services sites and communication towers for the transmission network.

Further inspection and vegetation management

Throughout the remainder of 2022, we will need to confirm that all storm-affected sections of the network have been rebuilt correctly. We will also need to continue our regular vegetation inspection to identify any additional storm-affected trees.

Expected cost reductions in the 2021-26 regulatory period

As well as creating new costs, some work that would have been required in future years and is part of the on-going cost of maintaining the network, was brought forward and carried out as a necessary part of the storm restoration activities. In particular, some assets replaced as a result of damage caused by the were due for end of life replacement in the near term, and so the work undertaken in the aftermath of the storm will reduce future asset replacement activity.

The reduction in future work will reduce our costs during the 2021-26 regulatory period. The forecast cost reductions in this regulatory period are shown in Table 2 below.

5.2 Assessment of materiality

Consistent with the approach adopted by the AER in its decision on our 2020 bushfire pass through application, we assessed the materiality of the cost increase by comparing the total increase in expenditure we incurred as a result of the event against the materiality threshold set out below. This approach is consistent with both the NER and the operation of the regulatory framework.

5.3 Materially higher costs

The additional operating expenditure (opex) and capital expenditure (capex) arising from the storm is material if it exceeds an amount equal to 1% of the annual revenue requirement established in the PTRM from the AER's revenue determination. We have incurred a material change in costs due to the October Storm.

Table 1 shows the additional opex and capex costs in 2021 we incurred and the savings we expect to incur in the second half of 2021, arising from the October Storm. Table 2 shows the cost savings we expect to achieve in the next regulatory period, and Table 3 presents the net increase in direct costs.

Table 1: October Storm incurred costs

\$ million (\$2021)	2021-22	2022-23	2023-24	2024-25	2025-26	Total
Emergency (replacement) capital works [^]	5.40	-	-	-	-	5.40
Emergency corrective works (opex)	3.29	-	-	-	-	3.29
Vegetation management (opex)	1.16	-	-	-	-	1.16
Audit fees (opex)	0.01	-	-	-	-	0.01

Source: AusNet

[^] Costs exclude overheads

Table 2: Forecast cost reductions in 2021-26 regulatory period

Categories of work (\$2021)	2021-22	2022-23	2023-24	2024-25	2025-26
Capital expenditure (replacement) [^]	- 0.06	-	-	-	-
Vegetation management (opex)	- 0.04	-	-	-	-

[^] Refer to Attachment 6 (A) and (B).

Source: AusNet

Table 3: October Storm incurred costs (net)

\$ million (\$2021)	2021-22	2022-23	2023-24	2024-25	2025-26	Total
Emergency (replacement) capital works [^]	5.34	-	-	-	-	5.34
Emergency corrective works (opex)	3.29	-	-	-	-	3.29
Vegetation management (opex)	1.12	-	-	-	-	1.12
Audit fees (opex)	0.01	-	-	-	-	0.01
Total	9.76	-	-	-	-	9.76

Source: AusNet

[^] Costs exclude overheads

The net increase in costs we have or are likely to incur due to the October Storm satisfies the materiality threshold, see the table below.

Table 4: Demonstrating material change in costs (Financial year 2021-22)

\$ million (nominal)	2021
Annual revenue requirement (ARR) (unsmoothed)	\$739.5
Total costs	\$10.0
Materiality of cost pass through	1.3%

Source: AusNet

6 Eligible and proposed cost through amounts

6.1 Eligible pas through amount

Clause 6.6.1(c)(3) of the NER requires us to specify the eligible pass through amount.

The eligible pass through amount is the increase in costs incurred in the provision of direct control services as a result of the pass through event.²⁷ It covers all expenditure including the capex and opex incurred and likely to be incurred until either the end of the regulatory period in which the positive change event occurred or, if cost recovery is to continue into the next period, the end of that regulatory period.

In determining the eligible pass through amount, only incremental costs attributable to the October Storm were included; No costs that would have been incurred under a business-as-usual (BAU) scenario form part of this application.

The costs set out in section 6.2 (below) comprise the eligible pass through amount.

Attachment 1 provides a build up of the costs incurred to determine the eligible pass through amount. Costs already incurred are identified (these entries have been reviewed, based on agreed upon procedures by KPMG) and a forecast of the costs yet to be incurred is provided.

6.2 Evidence of the costs for the eligible pass through amount

Clause 6.6.1(c)(6)(i) of the NER requires us to provide evidence of the actual and likely increase in costs included in the eligible pass through amount.

Table 5 and Table 6 below provide a breakdown of the opex and capex included in the eligible pass through amount. The costs include both actual costs and forecast costs for on-going inspection and vegetation management during 2021. The expenditure is categorised by activity.

²⁷ Definition of 'eligible pass through amount', chapter 10 of the National Electricity Rules.

Table 5: Storm incurred opex (net), breakdown

\$ million (\$2021)	2021-22	2022-23	2023-24	2024-25	2025-26
Emergency corrective works (opex)	3.29	-	-	-	-
Vegetation management (opex)	1.12	-	-	-	-
Audit fees (opex)	0.01	-	-	-	-
Total opex	4.42	-	-	-	-

Source: AusNet

Table 6: Storm incurred capex (net), breakdown

\$ million (\$2021)	2021-22	2022-23	2023-24	2024-25	2025-26
Emergency (replacement) capital works [^]	5.34	-	-	-	-
Total capex	5.34	-	-	-	-

Source: AusNet

[^] Costs exclude overheads

The actual costs already incurred in the tables above were extracted from our enterprise resource planning and accounting system (SAP). We engaged an independent consultant (KPMG) to review our cost recording to provide confidence that the actual costs contained in the eligible pass through amount are incurred were solely due to the October Storm (see confidential Attachment 7).

For on-going or future work, we prepared forecasts using the same principles that apply to the development of our regulatory proposals.

A breakdown of the eligible pass through amount is set out in the table below.

Table 7: Eligible pass through amount (\$2021 unsmoothed)

\$ million (\$2021)	2021-22	2022-23	2023-24	2024-25	2025-26
Return on capital	0.00	0.25	0.23	0.22	0.20
Return of capital	0.00	0.01	0.01	0.01	0.01
Operating expenditure	4.38	0.00	0.00	0.00	0.00
Tax	0.00	0.00	0.00	0.00	0.00
Building block revenue	4.38	0.25	0.24	0.23	0.22

Source: AusNet

Note 1: Totals may not sum due to rounding.

Note 2: In \$2021 smoothed terms, the equivalent total is \$5.7 million.

6.3 Costs included in eligible pass through amount are solely as a consequence of the positive change event

Clause 6.6.1(c)(6)(ii) of the NER requires us to provide evidence that the actual and likely increase in costs included in the eligible pass through amount occurred solely as a consequence of the positive change event. Similarly, clause 6.6.1(j)(5) requires the AER, in determining the approved pass through amount and the amount to be passed through to users in each regulatory year, to take into account the need to ensure the DNSP only recovers any actual or likely increment in costs that is solely as a consequence of the positive change event.

In calculating the eligible pass through amount, we included only the incremental costs for those activities that were incurred solely as a result of the positive change event. To be clear, we excluded the following costs from our claim:

- Fixed fees paid to our contractors that we would have paid if the October Storm did not occur.
- Office-based staff time, as these costs would have been incurred by the business in any event.

We captured expenditures that were in response to the October Storm in a manner consistent with our accounting framework, creating a specific project code in SAP²⁸ to clearly record and track the costs incurred due to the October Storm.

Our accounting structure allowed us to record costs as BAU or Storm-specific, and into capex and opex categories. Individual work orders e.g., for an identified pole replacement activity, were tracked using SAP to enable cost capturing at a detailed level throughout the storm response period.

To ensure confidence in the accuracy of the transactions recorded in our financial system, and as discussed in section 6.2, an independent consultant has reviewed our financial records based on agreed upon procedures (see confidential Attachment 7).

²⁸ Systems Applications and Products in Data Processing.

Clause 6.6.1(c)(c1) of the NER requires that the positive pass through amount proposed not include any expenditure for a restricted asset, unless in conjunction with a request for asset exemption. Although it is not clear whether the replacement of a restricted asset would require an exemption to be included in the positive pass through amount, we have no evidence to suggest that asset that was subject to network restoration works arising from the October Storm event would be classified as a restricted asset.

6.4 Efficiency of eligible pass through amount

Clause 6.6.1(j)(3) of the NER requires the AER, in determining the approved pass through amount and the amount to be passed through to users in each regulatory year, to take into account the efficiency of our decisions and actions in relation to the risk of the positive change event. This includes whether our actions minimised the magnitude of the eligible pass through amount.

Our preparedness for major incidents affecting the network and our actions to restore services after the impact of the October Storm together ensured an efficient response.

Being a disaster recovery response, the needs of communities severely impacted by the Storm and customer safety are necessarily high response priorities. We are well prepared to respond effectively and efficiently to incidents of all kinds that may impact our network. In our response to the October Storm, we utilised existing process and methods and contractual arrangements for regular network management activities and rapid response to natural disaster incidents such as storms and bushfires.

We have established, well documented and proven strategies and plans to be able to respond to incidents of varying causes and scales that may impact the network and our customers. These strategies include the setting up of an Emergency Management Team and, where appropriate, Critical Management teams to centralise decision making and ensure efficient timely collection and dissemination of information in real time. Our incident response processes also allow us to establish hubs of additional support capability to facilitate efficient response according to the circumstances.

To meet the challenges with the aftermath of the October Storm, we worked closely with the Victorian Government, AEMO and emergency services. We also deployed mobile generation units to some critical locations. Ariel, field and vegetation management teams were also established.

The field response utilised our internal resources and our contracted field works contractors. Importantly, our service delivery arrangements make provision for incident response, so the terms and conditions (including fees) for these arrangements is set via a commercial negotiation process and not during periods of crisis. This ensures efficient unit costs and clarity in the scope and cost of the services that can be mobilised at short notice, be it for asset inspection, line reconstruction or vegetation management. We consider that our approach proved to be very effective at facilitating a rapid, efficient response to the October Storm.

Insurance considerations

In accepting a 'natural disaster event' as a nominated pass through event in our distribution determination for 2021-26 regulatory period, the AER's Final Decision noted:

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

(1) whether AusNet Services has insurance against the event;

(2) the level of insurance that an efficient and prudent NSP would obtain in respect of the event.²⁹

We do not hold insurance cover for damage caused to the 'poles and wires' of the network by a natural disaster. The cost of holding this insurance is assessed when we routinely review our insurance needs and renegotiates insurance arrangements.

Through these reviews and by keeping abreast of trends in insurability, we can confirm that insurance cover for poles and wires is not an efficient approach to managing the risk of damage to or loss of these assets. There are several contributing reasons:

- The insurance cap available is extremely low in comparison to the value of the assets, and the value that may be impacted by one natural disaster event. The value (merit) is incomparable to the value of insuring assets located within our properties;
- The premium for including this risk is a significant proportion of the payout cap, as is the deductible; and
- If a claim was made under such cover, it is expected that the premium would increase significantly. This reflects the insurer's assessment of the likelihood of this risk being realised.

Insurance cover for the poles and wires is not readily available at economic rates. This was confirmed by our insurance broker who confirmed that none of its utility clients within Australia hold this form of cover. The broker explained that underwriters attempting to write this form of cover experience difficulty reinsuring the risk as reinsurers do not have appetite for this type of risk. It is understood that, absent reinsurance, the underwriters' concern stems from loss scenarios due to catastrophic weather events (fire, storm and cyclone), which may result in large insurance pay-outs. Thus, the few underwriters who have previously quoted this form of cover provide small aggregate limits with prohibitively expensive premiums.

Other DNSPs face similar whole of network insurance considerations, even though the nature of the local environment for some networks will differ. We have previously checked the approaches of some of our peer network operators on a confidential basis and can confirm that our practice of not insuring for this risk is consistent with those operators contacted.

Finally, to put the expensive cost of this cover in perspective, our current property insurance is based on a return period in excess of 1 in 100 years, whilst the poles and wire cover is based on a return period of 1 in 5. Thus, poles and wires cover is 20 times more expensive than traditional property cover.

6.5 Positive pass through amount

Clause 6.6.1(c)(4) of the NER requires us to specify the positive pass through amount that we propose in relation to the positive change event. The positive pass through amount is defined as an amount not exceeding the eligible pass through amount.

We propose a positive pass through amount of \$5.7 million (\$2021, smoothed).

We have calculated the proposed positive pass amount as the change in our required revenues for the 2021-26 regulatory period due to the positive change event. That is, our proposed positive pass through amount incorporates the opex and return on capital and return of capital for the 2021-26 regulatory period arising from the incremental expenditure from the October Storm, as well as the impact of the incremental costs on the cost of corporate income tax building block.

²⁹ AER, AusNet Services distribution determination final decision 2021–26, Attachment 15 – Pass through events, p. 15-18.

The PTRM used to calculate the pass through amount with this application is provided as Attachment 9.³⁰

6.6 Pass through amount in each regulatory year

Clause 6.6.1(c)(5) of the NER requires that we specify the amount that we propose to pass through to customers in the year, and each regulatory year after that, in which the positive change event occurred.

We propose to recover the proposed positive pass through amount of approximately \$1.9 million (smoothed, June 2021 dollars) in each regulatory year for the period from 1 July 2023 to 30 June 2026.

Recovering the positive pass through amount throughout the remainder of the current regulatory period will help smooth the price increase and will insulate our customers from a large one-off price increase in 2023.

7 Service Target Performance Incentive Scheme

The Service Target Performance Incentive Scheme (STPIS) is an incentive scheme that rewards businesses for continual reliability improvements. The STPIS targets represent the maximum amount of outages that we are allowed to incur over a 1-year period, before we are penalised for performance.

There are two important concepts to understand and distinguish when considering the STPIS:

- Our performance is measured relative to our STPIS targets, where Major Event Day (MED) exclusions are removed from our performance metrics. These exclusions remove days where our performance was impacted by factors outside of our control (such as storms and other catastrophic events) or because they are not representative of a normal day. This mechanism ensures the incentive we face to improve our performance is based on factors that we can control.
- A MED exclusion is a day in which the daily System Average Interruption Duration Index (SAIDI) exceeds a threshold value.

This means all events are included in the determination of MED thresholds, and the MED thresholds are used to identify MED exclusions.

Similar to the discussion outlined in our June 2021 cost pass through application, and as outlined to the AER in our application to suspend STPIS for storm-related outages (see Attachment 8), we consider the AER should exclude the October Storm in the calculation of our MED thresholds.

The inclusion of the October Storm will lead to artificially high MED thresholds that could result in the under-identification of MED exclusions. That would be an unreasonable outcome, as it would penalise us for catastrophic events that are rare and considered outliers. While the AER is still considering our proposal, our proposal will continue to ensure the STPIS provides a strong incentive for us to improve our performance over time.

³⁰ This PTRM is based on the PTRM submitted as part of our June 2021 cost pass through application, notwithstanding that application is with the AER for decision.

8 Attachments

Attachment 1 – Build up of costs

Attachment 2 – Compliance checklist

Attachment 3 – Confidentiality template

Attachment 4 – Proportion of confidential material

Attachment 5 – AusNet’s incident management governance

Attachment 6 (A) – Avoided 2022-26 capital expenditure

Attachment 6 (B) – Avoided 2022-26 capital expenditure RIN (Confidential)

Attachment 7 – Independent review of AusNet’s costs (Confidential)

Attachment 8 – Letter to AER regarding the suspension of STPIS for storm-related outages

Attachment 9 – AusNet Final Decision PTRM 2021-26 – Public