

Determination

Powercor

**Victorian Emergency Backstop
Mechanism Cost Pass Through**

September 2024

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Summary of our assessment

During the regulatory control period, Powercor can apply to pass through to its customers, in the form of higher or lower network charges, costs it incurs as a result of certain pre-defined exogenous events. These events are called cost pass through events.

On 7 June 2024, Powercor submitted a cost pass through application to the Australian Energy Regulator (AER), seeking to recover costs incurred in response to the Victorian Government introducing the Victorian Emergency Backstop Mechanism (VEBM).¹ The VEBM requires all new and replacement solar systems connected to distribution networks to be able to be remotely interrupted or curtailed when directed by Australian Energy Market Operator (AEMO) in a minimum system load event to maintain whole of system security.

Powercor submitted that it expects to incur total costs of \$19.7 million (\$2021) across capital and operating expenditure to comply with the VEBM, and is seeking to recover costs by increasing its revenue allowance by \$11.6 million (nominal, smoothed) for the 2021–26 period.

If the AER determines that a positive change event has occurred in respect of a cost pass through application, the AER is required to determine:

- the approved pass through amount, and
- how much of that amount should be passed through to distribution network users in the regulatory year, and each regulatory year after that, in which the positive change event occurred, taking into account the matters referred to in clause 6.6.1(j) of the NER.⁴

In making our determination on Powercor's pass through application, we must have regard to certain matters specified in the NER.²

We published Powercor's cost pass through application on 3 July 2024, and sought submissions from interested stakeholders. No submissions were received.

We are satisfied that the event described in Powercor's cost pass through application meets the definition of a service standard event in the NER. The VEBM is being implemented by the Victorian Government by altering Powercor's distribution licence through two ministerial orders. The new licence conditions together introduce new minimum service standards for embedded generating units connecting to the network, and materially alter the nature and scope of direct control services provided by Powercor.

Further, we consider the additional costs incurred and forecast to be incurred by Powercor to comply with the VEBM meet the materiality threshold for pass through in 2023–24. As such, we consider that a positive change event has occurred.

We have adjusted Powercor's proposed cost pass through amount to amend the proposed approach to adjusting for inflation. Subject to these modelling adjustments, we are satisfied that the costs Powercor has incurred, and is forecast to incur, are costs incurred solely as a

¹ Cl. 6.6.1(a) of the NER.

² Cl. 6.6.1(j) of the NER.

consequence of the VEBM and are likely to be prudent and efficient in the circumstances. These costs have been demonstrated to be incremental costs and separate to the business as usual costs of operating the distribution network. We are satisfied Powercor has identified the prudent scope of necessary works for it to comply with the VEBM Ministerial Orders. The costs Powercor has incurred and expects to incur are likely to reasonably reflect its efficient costs. Powercor has proposed a mix of equipment procurement and in-house build solutions to comply with the VEBM which likely represents the least cost approach to comply with the VEBM in the circumstances.

We have made adjustments to the total pass through costs to reflect our modelling changes. These adjustments have decreased the pass through amount by \$0.1 million (nominal, smoothed), from \$11.6 million (nominal, smoothed) to \$11.5 million (nominal, smoothed). Our adjustment is discussed in greater detail in section 4.4 of this report.

Our determination is to approve a positive pass through amount of \$11.5 million (nominal, smoothed) to be recovered in the final year of the current regulatory period (2025–26).

The approved pass through amount reflects the recovery of the opex incurred along with the return on and return of capital within the current regulatory period. The capital costs incurred will continue to be recovered over the life of the assets in future regulatory control periods.

We estimate that the approved cost pass through amount will add approximately \$7.4 (nominal) to average residential consumer bills in the 2025–26 year.

1 Introduction

We received a cost pass through application from Powercor for additional expenditure associated with costs incurred in response to the Victorian Government introducing the VEBM.

As a result, Powercor proposed to recover additional revenues of \$11.6 million (nominal, smoothed) from its customers in the current regulatory control period.

1.1 Who we are and our role in the process

We, the AER, exist to ensure all Australian energy consumers are better off, now and in the future. Consumers are at the heart of our work, and we focus on ensuring a secure, reliable and affordable energy future for Australia. We are the economic regulator for electricity and gas distribution and transmission services in the National Electricity Market (NEM), and our electricity-related powers and functions are set out in the National Electricity Law (NEL) and NER.

The AER regulates Powercor's revenues through five year distribution revenue determinations. The current revenue determination runs from 1 July 2021 to 30 June 2026.

We are responsible for assessing pass through applications. Under the pass through provisions in the NER, a distribution business may apply to us to seek the recovery of additional costs incurred during a regulatory control period arising from predefined events, specified in either the NER or in its revenue determination.³

1.2 Powercor's application

On 7 June 2024, Powercor submitted a cost pass through application to the AER, seeking to recover costs it has incurred and expects to incur in response to the Victorian Government introducing the VEBM.

The VEBM requires all new and replacement solar systems connected to distribution networks to be able to be remotely interrupted or curtailed when directed by AEMO in a minimum system load event to maintain whole of system security.

The VEBM is to be implemented by altering Powercor's distribution licence conditions in two stages:

- Stage 1, applying to new and replacement solar embedded generating units greater than 200 kW (Ministerial Order gazetted on 11 October 2023 and effective 25 October 2023)
- Stage 2, applying to new and replacement solar embedded generating units 200kW and below (Ministerial Order gazetted on 31 January 2024 and initially effective 1 July 2024). On 21 June 2024 the Victorian Government amended the VEBM to delay commencement of stage 2 until 1 October 2024.

³ Cl. 6.6.1 of the NER.

The key drivers of the incremental costs for Powercor associated with implementing the VEBM are:

- upgrades to digital systems, including procuring a utility server and building an inhouse scheduler. This will enable systems to communicate and enable remote control of inverters for new and upgraded solar systems
- upgrades to allow automated and secure communications and integration with broader IT architecture, including building interfaces that integrate Salesforce (customer relationship management), the scheduler and the utility server
- change management, including developing and formalising new business processes, documentation and training for staff and installers, and stakeholder engagement.

Powercor expects to incur total costs of \$19.7 million (\$2021) across capital and operating expenditure.

Table 1 shows the additional opex and capex costs that Powercor has incurred, and expects to incur, over its current 2021–26 regulatory control period as a result of the VEBM.

Table 1 Powercor’s proposed expenditure relating to the VEBM

\$million, (June 2021)	2021–22	2022–23	2023–24	2024-25	2025–26	Total
Opex expenditure	-	-	0.37	2.12	2.20	4.69
Capex expenditure	-	1.09	9.24	4.71	-	15.05
Total expenditure	-	1.09	9.61	6.83	2.20	19.73

Source: Powercor - Cost pass through application.

Powercor claimed confidentiality over a cost model it submitted to us in support of its cost pass through application detailing its market sensitive cost information.⁴ This included cost details which may compromise a competitive tender process and negotiation positions. We have reviewed and accepted Powercor’s confidentiality claims.

⁴ However, Powercor provided a public version of its application, which is available on our website [here](#).

2 Determination

Based on our consideration of the matters set out in this decision, we consider that Powercor's application establishes that a pass through event has occurred in respect to the introduction of the VEBM, being a service standard event. Our assessment against the requirements of a positive change event is summarised in section 5 (Tables 5 and 6).

We are satisfied that the VEBM constitutes a positive change event as defined under the NER. In particular, we are satisfied that Powercor has incurred a material increase in costs in the 2023-24 regulatory year as a result of this pass through event.

Our determination is to approve a positive pass through amount of \$11.5 million (nominal, smoothed) to be recovered in 2025-26, the final year of Powercor's regulatory control period, through the X-factor set in the PTRM.

In making this determination, we have taken into account relevant factors in the NER, including:⁵

- the matters and proposals set out in Powercor's service standard event cost pass through application
- the incremental costs incurred by Powercor as a consequence of the positive change event
- the efficiency of Powercor's decisions and actions in relation to the positive change event, and
- whether the costs of the pass through event have already been factored into Powercor's revenue for the 2021–26 regulatory control period.

Sections 4 and 5 set out our assessment of Powercor's cost pass through application and the positive pass through amount.

⁵ Cl. 6.6.1 of the NER.

3 Relevant regulatory requirements and assessment approach

The first step in our assessment is to determine whether a pass through event has occurred and examine timing matters, e.g. whether an application is submitted within the timeframe set out in the NER. Once we have determined that a pass through event has occurred, we are to determine whether it is a positive (or negative) change event.

The NER defines a positive change event for a DNSP as:

“a pass through event...which entails the DNSP incurring materially⁶ higher costs in providing direct control services than it would have incurred but for that event...”⁷

Powercor submitted that the introduction of the VEBM represented a service standard event which imposes new minimum service standards regarding connection of embedded generation up to 30MVA; and alters the scope of the direct control services provided by Powercor.

We undertake our assessment with reference to the NER and the revenue determination applicable to Powercor when the service standard event occurred, which is Powercor’s distribution determination for the 2021–26 regulatory control period.

As part of this process, we examine whether Powercor’s application has addressed matters specified in clause 6.6.1(c) of the NER (see section 5 below (Table 5 and Table 6)). We also determine the materiality of the proposed pass through amount.

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

- the approved pass through amount, and
- the amount that should be passed through to distribution network users in the regulatory year, and each regulatory year after that, in which the positive change event occurred, taking into account the factors referred to in clause 6.6.1(j) of the NER.

3.1 Timing matters

To seek the approval of the AER to pass through a positive pass through amount, clause 6.6.1(c) of the NER requires a DNSP to submit a written statement specifying a range of details relating to the event within 90 business days of the positive change event occurring.

The NER requires us to make a determination within the timeframe specified in clause 6.6.1(e), that is, within 40 business days from the later of the date the AER received the cost pass through application and the date it received any additional information required by it through a notice issued under clause 6.6.1(e1) of the NER.

⁶ Materially higher costs means the costs incurred or likely to be incurred in any regulatory year of a regulatory control period, as a result of that event, exceed 1% of the maximum allowed revenue for that year.

⁷ NER, chapter 10.

4 Reasons for determination

The sections below set out the reasons for our determination.

4.1 Occurrence of service standard event

The first step in our assessment is to assess whether a pass through event has occurred.

Powercor submitted that the VEBM Ministerial Orders qualify as a service standard event⁸, which is provided for and defined as follows in the NER:

A legislative or administrative act or decision that:

(a) *has the effect of:*

(i) substantially varying, during the course of a regulatory control period, the manner in which a Transmission Network Service Provider is required to provide a prescribed transmission service, or a Distribution Network Service Provider is required to provide a direct control service; or

(ii) imposing, removing or varying, during the course of a regulatory control period, minimum service standards applicable to prescribed transmission services or direct control services; or

(iii) altering, during the course of a regulatory control period, the nature or scope of the prescribed transmission services or direct control services, provided by the service provider; and

(b) materially increases or materially decreases the costs to the service provider of providing prescribed transmission services or direct control services.

The VEBM is being implemented by the Victorian Government by altering Powercor's distribution licence through two ministerial orders. These new licence conditions together introduce new minimum service standards for embedded generating units connecting to the network, and materially alter the nature and scope of direct control services provided by Powercor. We are therefore satisfied that Powercor's cost pass through meets the requirements for a service standard event.

4.2 Positive change event

If we are satisfied that a pass through event has occurred, we must determine whether the pass through event qualifies as a "positive change event". That is, whether Powercor incurred materially higher costs in providing direct control services than it would have incurred but for the pass through event.

The NER defines "materially" as follows:

For the purposes of the application of clause 6.6.1, an event results in a Distribution Network Service Provider incurring materially higher or materially

⁸ NER, Chapter 10.

lower costs if the change in costs (as opposed to the revenue impact) that the Distribution Network Service Provider has incurred and is likely to incur in any regulatory year of a regulatory control period, as a result of that event, exceeds 1% of the annual revenue requirement for the Distribution Network Service Provider for that regulatory year.

We consider the additional costs incurred and forecast to be incurred by Powercor as a result of the VEBM meet the materiality threshold in 2023-24, as demonstrated in Table 2 below.

Table 2 Materiality assessment of Powercor VEBM cost pass through

	2021–22	2022–23	2023–24	2024-25	2025–26	Total
AER Opex expenditure (\$million 2021)	-	-	0.36	2.10	2.17	4.63
AER Capex expenditure (\$million 2021)	-	1.08	9.13	4.66	-	14.88
AER Total expenditure (\$million 2021)	-	1.08	9.50	6.76	2.17	19.51
Approved unsmoothed revenue (\$million 2021)	-	646.96	670.62	688.34	673.01	2,678.93
Materiality (%)	-	0.17	1.42	0.98	0.32	0.73

Source: AER analysis.

4.3 Timing of Powercor’s application

The NER requires a DNSP to submit a cost pass through application to us within 90 business days of the positive change event occurring.

We consider that the positive change event occurred on 31 January 2024, being the date the final stage two ministerial order was gazetted. We received Powercor’s cost pass through application on 7 June 2024, which was within 90 business days of the positive change event occurring.

Following our initial assessment of Powercor application, we issued an information notice to Powercor under clause 6.6.1(e1) of the NER, requesting further information on the scope of works and associated costs.

An information notice was issued on 11 July 2024 and we received Powercor’s response on 26 July 2024. Accordingly we are required to make this determination by 20 September 2024.

4.4 Assessment of the pass through amount

In assessing a pass through application, the NER requires us to take into account a range of relevant factors, including the need to ensure that Powercor only recovers any actual or likely incremental costs, to the extent that such an increment is solely as a consequence of the pass through event, and that Powercor does not recover costs that have or will be factored into Powercor’s annual revenue requirement.

We approach this assessment by ensuring, amongst other factors, that:

- the pass through amount reflects only those costs incurred as a result of the service standard event, and not business-as-usual costs, or costs of increasing the scope of network services provided by Powercor;
- the costs incurred are prudent and efficient costs required to comply with the VEBM obligations
- the pass through amount reflects only the incremental costs required in responding to the VEBM, taking into account any deductions for actual or expected cost savings.

We have adjusted Powercor proposed cost pass through amount to amend the proposed approach to adjusting for inflation. Subject to these adjustments, we are satisfied that the costs Powercor has incurred, and is forecast to incur, are costs incurred solely as a consequence of the VEBM and are likely to be prudent and efficient in the circumstances. These costs have been demonstrated to be incremental costs and separate to the business as usual costs of operating the distribution network.

Our determination on the approved incremental revenue for the Victorian Emergency Backstop Mechanism is set out below in Table 3.

Table 3 AER approved incremental revenue resulting from the VEBM (\$million, nominal)

\$million, nominal	2021–22	2022–23	2023–24	2024-25	2025–26	Total
Return on capital	-	-	0.05	0.51	0.55	1.11
Return of capital (regulatory depreciation)	-	-	0.20	1.95	2.94	5.09
Operating expenditure	-	-	0.39	2.27	2.40	5.06
Net tax amount	-	-	-	-	-	-
Incremental annual revenue requirement (unsmoothed)	-	-	0.64	4.73	5.89	11.26
Incremental annual expected revenue (smoothed)	-	-	-	-	11.51	11.51

Source: AER analysis

4.4.1 Incremental revenue and pass through amount calculations

Powercor’s application included \$19.7 million (\$2021) of additional capital and operating costs (total expenditure or totex) required to address the VEBM. We assessed Powercor’s proposed costs, and requested further information in regard to incurred and forecast costs in the current period. After reviewing Powercor responses, we have reduced the proposed additional costs by \$0.2 million (\$2021) to ensure that only actual and likely costs needed to directly comply with the VEBM are recovered, as shown in Table 4 below. Our reasoning is explained further below.

Table 4 AER approved incremental capex and opex expenditure for the VEBM

\$million, (June 2021)	2022-23	2023-24	2024-25	2025-26	Total
Proposed cost pass through totex	1.09	9.61	6.83	2.20	19.73
Approved cost pass through totex	1.08	9.50	6.76	2.17	19.51
Difference	-0.01	-0.11	-0.08	-0.02	-0.22

Source: AER analysis

Cost build up model and PTRM

We issued an information request to Powercor under clause 6.6.1(e1) of the NER, requesting confirmation of a change in the CPI conversion calculation. In Powercor's response it confirmed the AER's alternative approach to the CPI conversion calculation, and provided an updated cost build up model. This resulted in minor changes to the total approved costs.

4.4.2 Costs represent the prudent and efficient costs to comply with the VEBM

In order to assess the efficiency of the opex and capex costs identified by Powercor in its cost pass through application, we have examined the scope of actions and works Powercor has undertaken and planned in response to the VEBM service standard event. We considered the necessity of the works, and the basis of cost estimates. We reviewed the cost model provided by Powercor and issued information notices to obtain further details to ensure that the proposed costs were incremental to existing allowances, and efficient in the context of the new VEBM obligations.

Excluding the minor changes to the cost build up model, we are satisfied Powercor has demonstrated prudence in identifying the scope of necessary works to comply with the VEBM Ministerial Orders. This includes the costs required for:

- building an inhouse scheduler to register devices, create customer export schedules, collate, and store data and provide a way for the network to trigger zero export commands
- procuring, installing and configuring a compliant utility server
- upgrades to allow automated and secure communications and integration with broader IT architecture
- change management, including developing and formalising new business processes, documentation and training for staff and installers, and stakeholder engagement.

We also understand that the functionality of the system being established is limited to that required to comply with the VEBM. We consider this to be appropriate in the context of this pass through application.

Based on our review of Powercor's application and supporting information, we are satisfied that the costs Powercor has incurred, and the estimated costs it expects to incur, as a result of the VEBM are likely to reasonably reflect efficient costs in the circumstances.

Powercor has proposed a mix of equipment procurement and in-house build solutions to comply with the VEBM. We are satisfied that the procurement of a utility server along with the additional labour for in-house upgrades to systems and processes would likely represent the least cost approach for Powercor to comply with the VEBM, given the mandated timelines. The internal cost estimates and labour rates provided in the cost model are consistent with market tested rates accepted in Powercor's current revenue determination.

4.5 Timing of cost pass through recovery

Powercor proposed to recover the incremental revenue arising from its cost pass through application in the last year (2025-26) of its 2021–26 regulatory period. The approved pass through amount will be recovered in the final year of the current period (2025-26).

5 NER requirements

For a cost pass through to be determined, there must be a positive change event that results in an eligible pass through amount. Powercor can then submit a pass through application, that must address certain matters specified in the NER.⁹ We make a determination on Powercor’s cost pass through application and determine the approved pass through amount and the regulatory years in which that pass through amount is to be recovered.¹⁰

For the reasons set out in Table 5, we are satisfied a positive change event has occurred, and that Powercor’s application relating to the VEBM specifies the necessary matters required by the NER. Additionally, after considering the factors set out in Table 6, we are satisfied the appropriate pass through amount is \$11.5 million (nominal, smoothed), to be recovered in 2025-26, the final year of Powercor’s 2021–26 regulatory control period.

Table 5 Requirements for determining a positive change event has occurred

Requirement of the NER	Our consideration
Is the pass through event a regulatory change event, service standard event, tax change event, or retailer insolvency event? ¹¹	Yes
Is the pass through event a contingent project or a trigger event associated with a contingent project? ¹²	No
Did the Victorian Emergency Backstop Mechanism cost pass through event entail Powercor incurring materially higher costs in providing direct control services than it would have incurred but for the event? ¹³	Yes. As discussed in section 4.2, we consider the additional costs incurred by Powercor as a result of the VEBM meet the materiality threshold. Powercor’s annual revenue requirement (unsmoothed) for the 2023–24 year was \$670.62 million (\$2021), 1% of which is \$6.71 million (\$2021). We consider the efficient amount of opex and capex incurred as a result of the VEBM in 2023-24 (\$9.50 million, \$2021 unsmoothed) exceeds this amount, and therefore the increase in costs as a result of the event is material.
What is the date on which the positive change event occurred?	The VEBM is comprised of 2 stages, the first gazetted on 11 October 2023 and the second on 31 January 2024. Powercor has submitted that these two stages combine to create one event that occurred when stage 2 was gazetted. We agree with Powercor that the positive change event occurred on 31 January 2024.
Did Powercor submit a written statement of its pass through application within 90 business days of the positive change event occurring? ¹⁴	Yes. Powercor submitted its application on 7 June 2024 which is within the allowed timeframe.
Did Powercor specify in its written statement the eligible pass through amount, the proposed positive pass through amount, and the amounts proposed to be recovered from customers in each year? ¹⁵	Yes. Powercor proposed an eligible positive pass through amount of \$11.6 million (nominal, smoothed) to be recovered from consumers in 2025–26, the last year of the current regulatory control period.

⁹ NER, cl. 6.6.1(c).

¹⁰ NER, cl. 6.6.1 (d).

¹¹ NER, cl. 6.6.1(a1)(1) through 6.6.1(a1)(4); and chapter 10.

¹² See the definition of “positive change event” in chapter 10 of the NER.

¹³ That is, does it meet the definition of a positive change event as defined in chapter 10 of the NER.

¹⁴ NER, cl. 6.6.1(c).

¹⁵ NER, cl. 6.6.1(c)(3), 6.6.1(c)(4), and 6.6.1(c)(5).

Did Powercor specify in its written statement evidence of the actual and likely increase in costs that occurred solely as a consequence of the positive change event? ¹⁶	Yes. Powercor’s pass through application set out the costs it incurred as a result of the VEBM, the costs excluded from its proposal, as well as how it calculated its proposed pass through amount.
Was there a regulatory information instrument applicable to the pass through application? ¹⁷	No
Is the pass through amount, in whole or in part, in respect of expenditure for a restricted asset? ¹⁸	No

Table 6 Factors that the AER is to consider under the NER when determining a positive pass through amount

Relevant factors under cl. 6.6.1(j)	AER consideration
In making the pass through determination we must take into account the matters and proposals set out in Powercor’s written statement. ¹⁹	This decision sets out how we have taken into account the matters and proposals set out in Powercor’s pass through application (written statement).
We must take into account the incremental increase in costs resulting from the pass through event. ²⁰	In section 4.4 above we set out our assessment of the costs incurred and likely to be incurred by Powercor as a consequence of the VEBM service standard event.
We must take into account the time cost of money. ²¹	To account for the recovery of the pass through amount in 2025–26, we have used the nominal rate of return, as determined in Powercor 2021–26 distribution determination reflecting the most recent return on debt update in the approved PTRM.
We must take into account the need to ensure that the pass through amount reflects only costs incurred solely as a consequence of the VEBM. ²²	We have investigated the costs proposed by Powercor in its proposal and response to our subsequent information requests. We are satisfied that the costs included in our approved pass through amount were solely incurred to comply with the VEBM.
We must take into account whether the costs of the pass through event have already been factored into the calculation of the Distribution Network Service Provider’s annual revenue requirement for the regulatory control period in which the pass through event occurred or will be factored into the calculation of the Distribution Network Service Provider’s annual revenue requirement for a subsequent regulatory control period ²³	We do not consider the costs that Powercor has proposed to recover have been factored into Powercor’s annual revenue requirement for the regulatory control period in which the pass through event occurred (i.e. 2021-26).
We must take into account the extent to which Powercor costs have already been funded by previous pass through determinations. ²⁴	There is no evidence to suggest that costs included Powercor application have already been funded by previous pass through determinations.
We must take into account any other factors that we consider relevant. ²⁵	There are no other factors we took into account in our assessment of Powercor’s application.

¹⁶ NER, cl. 6.6.1(c)(6).

¹⁷ NER, 6.6.1(c)(7).

¹⁸ NER, cl. 6.6.1(c1) and (d2).

¹⁹ NER, cl. 6.6.1(j)(1).

²⁰ NER, cl. 6.6.1(j)(2).

²¹ NER, cl. 6.6.1(j)(4).

²² NER, cl. 6.6.1 (j)(5).

²³ NER, cl. 6.6.1(j)(7).

²⁴ NER, cl. 6.6.1(j)(7A).

²⁵ NER, cl. 6.6.1(j)(8).

Glossary

Term	Definition
AER	Australian Energy Regulator
Capex	Capital Expenditure
DNSP	Distribution Network Service Provider
NEL	National Electricity Law
NEM	National Electricity Market
NER	National Energy Rules
NSP	Network Service Provider
Opex	Operating Expenditure
AEMO	Australian Energy Market Operator
VEBM	Victorian Emergency Backstop Mechanism
AER	Australian Energy Regulator