



# **FINAL DECISION**

## **AusNet Services Distribution Determination 2021 to 2026**

### **Attachment 15 Pass through events**

April 2021

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AER reference: 63599

## Note

This attachment forms part of the AER's final decision on the distribution determination that will apply to AusNet Services for the 2021–26 regulatory control period. It should be read with all other parts of the final decision.

The final decision includes the following attachments:

### Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

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# 15 Pass through events

The pass through mechanism of the National Electricity Rules (NER) recognises that a distributor can be exposed to risks beyond its control, which may have a material impact on its costs. A cost pass through enables a distributor to recover (or pass through) the costs of defined yet unpredictable, high cost events that are not built into our distribution determination. The NER include the following prescribed pass through events for all distributors:

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

In addition to these prescribed events, other pass through events may be 'nominated' by a service provider for a regulatory control period.

This attachment sets out our final decision on the nominated pass through events that will apply to AusNet Services for the 2021–26 regulatory control period.

## 15.1 Final decision

Our final decision is that the following nominated pass through events will apply to AusNet Services for the 2021–26 regulatory control period:

- insurance coverage event
- insurer credit risk event
- natural disaster event
- terrorism event
- retailer insolvency event.

These events are defined in Table 15.2. The reasons for our decisions are set out in section 15.5. We have also accepted some of the minor proposed amendments to the insurance coverage event and made minor amendments to the definitions for the natural disaster and terrorism events. Our reasons for these decisions are set out in sections 15.5.1 and 15.5.2.

Our final decision is to not accept the proposed insurance premium event, environment protection event and major cyber event. Our reasons for these decisions are set out in sections 15.5.3, 15.5.4 and 15.5.5.

## 15.2 AusNet Services' revised proposal

In our draft decision we did not accept all the nominated pass through events proposed by AusNet Services.<sup>1</sup> Instead we substituted our own event definitions of natural disaster, retailer insolvency and insurance coverage to provide consistency between AusNet Services and other service providers.<sup>2</sup> Additionally, we did not accept AusNet Services' proposed insurance premium and electrical vehicle uptake nominated events.<sup>3</sup>

In its revised proposal, AusNet Services accepted our draft decision in relation to the following pass through events:<sup>4</sup>

- insurer credit risk event;
- natural disaster event;
- terrorism event; and
- retailer insolvency event.

It welcomed our draft decision to accept the insurance coverage event suggesting minor amendments to the definition and accepted our decision not to accept the electric vehicle uptake nominated event.<sup>5</sup>

AusNet Services did not accept our draft decision with respect to the insurance premium event. It provided additional information to demonstrate that a cost pass through mechanism is the appropriate regulatory mechanism to recover the cost of materially higher insurance premiums, and stated that this event meets the nominated pass through event considerations. AusNet Services also proposed minor amendments to its original definition of the insurance premium event to align with the drafting proposed by the other Victorian distributors.<sup>6</sup>

AusNet Services also proposed two new pass through events:<sup>7</sup>

- an environment protection pass through event associated with amendments to the *Environment Protection Act (EPA) 2017 (Vic)*. This is intended to ensure access to the pass through framework if AusNet Services was to incur costs in future to comply with the amended environment protection legislation and associated subordinate instruments.
- a major cyber cost pass through event. This event is intended to address any material risk associated with a cyber-attack that it considered is not available under

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<sup>1</sup> AER, *Draft Decision, AusNet Services determination, Attachment 15*, September 2020, p. 4.

<sup>2</sup> AER, *Draft Decision, AusNet Services determination, Attachment 15*, September 2020, pp. 4, 12-15.

<sup>3</sup> AER, *Draft Decision, AusNet Services determination, Attachment 15*, September 2020, pp. 15-17.

<sup>4</sup> AusNet Services, *Revised regulatory proposal 2022–26*, December 2020, p. 153.

<sup>5</sup> AusNet Services, *Revised regulatory proposal 2022–26*, December 2020, p. 153.

<sup>6</sup> AusNet Services, *Revised regulatory proposal 2022–26*, December 2020, pp. 156–159.

<sup>7</sup> AusNet Services, *Revised regulatory proposal 2022–26*, December 2020, pp. 153, 162–166.

the existing cost recovery frameworks for the totality of the costs incurred as a result of such an attack.

## 15.2.1 Stakeholder submissions

We received four submissions on the revised proposals of the Victorian distributors which raised issues about the proposed nominated pass through events that are relevant to AusNet Services.<sup>8</sup> At a high level, submissions did not support the environment protection and major-cyber nominated events. We have taken these submissions, and any other concerns consumers identified, into account in developing the positions set out in this final decision. A summary of the nominated cost pass through issues raised in submissions is provided in Table 15.1.

**Table 15.1 Stakeholder submissions**

Stakeholder	Issue	High Level summary and reference
AER Consumer Challenge Panel, sub-panel 17 (CCP17), Victorian Community Organisations (VCO), Energy Consumers Australia (ECA), Energy Users Association of Australia (EUAA)	Pass-throughs	<p>The CCP17 did not consider that any provision is needed for changes in EPA costs in the Final Determination, unless the Victorian Parliament legislates before the determination is finalised. It also considered environmental pass-through events are unnecessary. The CCP17 also noted the increased use of pass throughs as a response to uncertainty from COVID. The CCP17 queried this approach and suggested it only occur where established rules and processes are inadequate.<sup>9</sup></p> <p>The VCO did not support the inclusion of EPA regulation as a pass through, and expressed tentative support of the insurance coverage event but noted detailed examination of the approach would be required. There was also support for a “bushfire insurance event” but that it should not include more general insurance. The VCO also did not support the major cyber event pass through.<sup>10</sup></p> <p>EUAA<sup>11</sup> and ECA’s consultant Spencer and Co<sup>12</sup> did not support a nominated major cyber cost pass through event.</p> <p>The VCO supported analysis of the insurance premium proposals to ensure that the step change and cost pass through events are not double counted. It noted there is support for developing the most efficient bushfire insurance program for each business, with consumers sharing in the increased costs and risks, including general insurance, which it considered had not been impacted by the increased bushfire risk.<sup>13</sup></p>

<sup>8</sup> CCP17, *Submission on the Victorian EDPR Revised Proposal and draft decision 2021–26*, January 2021, p. 69; VCO, *Submission on the Victorian EDPR Revised Proposal and draft decision 2021–26*, January 2021, pp. 28-29, 56, 64-66 (Headberry Partners P/L); EUAA, *Submission on the Victorian EDPR Revised Proposal and draft decision 2021–26*, January 2021, p.11; Spencer&Co report to ECA, *Submission on the Victorian EDPR Revised Proposal and draft decision 2021–26*, January 2021, pp.15, 19.

<sup>9</sup> CCP17, *Submission on the Victorian EDPR Revised Proposal and draft decision 2021–26*, January 2021, p. 69.

<sup>10</sup> Headberry Partners report to VCO, *Submission on the Victorian EDPR Revised Proposal and draft decision 2021–26*, January 2021, pp. 28-29, 64–66.

<sup>11</sup> EUAA, *Submission on the Victorian EDPR Revised Proposal and draft decision 2021–26*, January 2021, p.11.

<sup>12</sup> Spencer&Co report to ECA, *Submission on the Victorian EDPR Revised Proposal and draft decision 2021–26*, January 2021, p. 19.

<sup>13</sup> Headberry Partners report to VCO, *Submission on the Victorian EDPR Revised Proposal and draft decision 2021–26*, January 2021, p. 56.

Stakeholder	Issue	High Level summary and reference
		Consultants for ECA, Spencer&Co supported the steps taken by businesses to mitigate the costs impacts of rising insurance premiums on customers. They considered the pass through of payments up to the deductible in the case that an event occurs is a reasonable sharing of risk between networks and customers. They also suggest that the AER should consider a review of insurance offerings to determine if market offerings properly reflect the risk of these events. <sup>14</sup>

Source: AER analysis

## 15.3 Assessment approach

The NER sets out how we must assess nominated pass through events, and how we must assess an application from a service provider to pass through changes in costs where an event occurs.<sup>15</sup>

Our assessment approach is guided by the National Electricity Objective (NEO) and the Revenue and Pricing Principles.<sup>16</sup> One of the Revenue Pricing Principles is that the service provider should have a reasonable opportunity to recover at least the efficient costs of providing services and complying with regulatory obligations.<sup>17</sup> The NEO and the Revenue Pricing Principles also reflect the importance of incentives to promote economic efficiency,<sup>18</sup> and balance the risks of under and over investment.<sup>19</sup>

In the context of pass through events, we have particular regard to the impact on price, quality, reliability and security of supply that may arise as a result of any change in the efficient operation of, and ability and incentive of, a service provider to invest in its network. This is a similar approach to that taken by the Australian Energy Market Commission (AEMC) when considering pass through event rule changes.<sup>20</sup>

In determining whether we accept a nominated pass through event, we must take into account the 'nominated pass through event considerations' as defined, which are as follows:<sup>21</sup>

- 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);

<sup>14</sup> ECA, *Submission on the Victorian EDPR Revised Proposal and draft decision 2021–26*, January 2021, p. 15 (Spencer&Co).

<sup>15</sup> NER, cl. 6.5.10(b), 6.6.1.

<sup>16</sup> NEL, ss. 7 and 7A.

<sup>17</sup> NEL, s. 7A(2).

<sup>18</sup> NEL, s. 7A(3).

<sup>19</sup> NEL, s. 7A(6).

<sup>20</sup> AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 6.

<sup>21</sup> NER, Chapter 10, definition of nominated pass through event considerations.



- whether the nature or type of event can be clearly identified at the time the determination is made for the service provider;
- whether a prudent service provider could reasonably prevent an event of that nature or type from occurring or substantially mitigate the cost impact of such an event;
- whether the relevant service provider could insure against the event, having regard to:
  - the availability (including the extent of availability in terms of liability limits) of insurance against the event on reasonable commercial terms; or
  - whether the event can be self-insured on the basis that:
    - it is possible to calculate the self-insurance premium; and
    - the potential cost to the relevant service provider would not have a significant impact on the service provider's ability to provide network services; and
- any other matter the AER considers relevant and which the AER has notified 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.<sup>22</sup>

that a pass through event should only be accepted when it is the least inefficient option and event avoidance, mitigation, commercial insurance and self-insurance are found to be inappropriate. That is, it is included after ascertaining the most efficient allocation of risks between a service provider and end customers.<sup>23</sup>

This protects the incentive regime under the NER by limiting erosion of a service provider's incentives to use market based mechanisms to mitigate the cost impacts that would arise.<sup>24</sup> This promotes the efficient investment in, and efficient operation and use of, network services for the long term interests of consumers with respect to price.<sup>25</sup>

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<sup>22</sup> AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 19.

<sup>23</sup> AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 20.

<sup>24</sup> AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 8.

<sup>25</sup> AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 8.

As a matter of good regulatory practice, we also take into account the desirability of consistency in our approach to assessing nominated pass through events across our electricity determinations and gas access arrangements.<sup>26</sup>

## 15.4 Interrelationships

As discussed in our draft decision, the pass through mechanism is not the only way service providers can manage their risks under a distribution or transmission determination. It is interrelated with other parts of this determination, in particular with AusNet Services' forecast operating expenditure (opex), capital expenditure and the rate of return included in our revenue determination. We must specify and take account of these interrelationships.<sup>27</sup> This requires us to balance the incentives in the various parts of our decision.

## 15.5 Reasons for final decision

### 15.5.1 Insurance coverage event

Our final decision is to include the insurance coverage event. The only change from the draft decision definition is we have accepted one of the amendments proposed by AusNet Services.

AusNet Services proposed a number of definitional amendments to the insurance coverage event,<sup>28</sup> which are essentially the same as what the other Victorian distributors have also proposed. We understand the amendments proposed by the Victorian electricity distributors intended to clarify the operation of the insurance coverage event.

When we replaced the insurance cap event with the insurance coverage event<sup>29</sup>, we inserted three key changes to the definition:

- "changed circumstances" means movements in the relevant insurance liability market that are beyond the control of the network business, where those movements mean that it is no longer possible for the network business to take out an insurance policy or set of insurance policies at all or on reasonable commercial terms that include some or all of the costs referred to in the definition within the scope of that insurance policy or set of insurance policies
- "costs" means the costs that would have been recovered under the insurance policy or set of insurance policies had:

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<sup>26</sup> AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 18.

<sup>27</sup> NEL, s. 16(1)(c).

<sup>28</sup> AusNet Services, *Revised regulatory proposal 2022–26*, December 2020, pp. 154–155.

<sup>29</sup> AER, *Final Decision, SA Power Networks Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 13–14; AER, *Final Decision, Ergon Energy Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 9–10; AER, *Final Decision, Energex Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 9–10.

- the limit not been exhausted; or
- those costs not been unrecoverable due to changed circumstances.
- "a relevant insurance policy or set of insurance policies" means an insurance policy or set of insurance policies held during the regulatory control period or a previous regulatory control period in which a network business was regulated.

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

We have also applied the draft decision insurance coverage definition to other service providers<sup>30</sup> and we consider it would be preferable to maintain a consistent definition across network businesses rather than update the definition with the following proposed minor amendments:<sup>31</sup>

- clarifying that unrecoverable costs may include such costs "whether wholly or in part"
- clarifying that costs may be incurred "either separately or in aggregate"
- providing the definition for the base year
- clarifying that "changed circumstances" includes movements in the relevant insurance liability market "since the acquisition of the insurance policy or set of insurance policies that applied during the majority of the base year".

A further amendment proposed by AusNet Services is that "changed circumstances" should mean movements in the relevant insurance liability market that result in it no longer being possible for AusNet Services to take out a relevant insurance policy with a "reputable insurer".<sup>32</sup> We consider that the decision for AusNet Services to seek appropriate insurance cover on reasonable commercial terms is solely in the domain of the business, and we expect that AusNet Services will safeguard that business decision. We do not consider it necessary to prescribe the insurers who AusNet Services may seek coverage from.

We accept the proposed amendment to include "any guidance published by the AER on matters the AER will likely have regard to in assessing any insurance coverage event that occurs" as a matter that the AER will have regard to in assessing an

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<sup>30</sup> AER, *Final Decision, SA Power Networks Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 13–14; AER, *Final Decision, Ergon Energy Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 9–10; AER, *Final Decision, Energex Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 9–10.

<sup>31</sup> AusNet Services, *Revised regulatory proposal 2022–26*, December 2020, pp. 154–155.

<sup>32</sup> AusNet Services, *Revised regulatory proposal 2022–26*, December 2020, pp. 154–155.

insurance coverage pass through event application.<sup>33</sup> This aligns with our work to release a final guidance note on the insurance coverage pass through event following further consultation with stakeholders in July 2021.<sup>34</sup>

### **15.5.2 Insurer credit risk, natural disaster, terrorism and retailer insolvency event**

AusNet Services accepted our draft decision on insurer credit risk, natural disaster, terrorism and retailer insolvency events.<sup>35</sup> As a result, we have included these events in our final decision. However, we have made minor amendments to the definitions of natural disaster and terrorism events to reflect the symmetry between positive and negative cost pass through events reflected in the NER and add clarity.<sup>36</sup> Specifically, in these two event definitions we have replaced "increases the costs" with "changes the costs". We also adopted an additional explicit reference to "cyclone" and "earthquake" in the definition of natural disaster event as proposed by Jemena.<sup>37</sup> The amended definitions are set out in Table 15.2.

### **15.5.3 Insurance premium event**

AusNet Services' re-proposed an insurance premium cost pass through event in its revised proposal, stating that the insurance coverage event cost pass through does not allow a business to recover material increases in its insurance premiums.<sup>38</sup>

AusNet Services' re-proposal of an insurance premium event is intended to address potentially higher premium costs in the next regulatory control period. These would be additional to the higher costs AusNet Services proposed as an insurance premium step change in its revised opex proposal. The proposed step change costs reflect premium increases known as a result of its 2020 insurance renewal. The insurance premium cost pass through event would be for any additional increases.<sup>39</sup>

For reasons outlined below, we consider on balance that the long term interests of consumers is better served if the appropriate incentives remain with the businesses to actively work to moderate expected increases in insurance premiums over the next regulatory control period. As a result, our final decision is to not accept an insurance premium cost pass through event, but rather to include forecast insurance premium costs as a part of AusNet Services' opex for the 2021–26 regulatory control period.

As set out above, under the NER, a business may propose a nominated pass through event in its revenue proposal. The AER must then assess any such proposals and take

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<sup>33</sup> AusNet Services, *Revised regulatory proposal 2022–26*, December 2020, pp. 154–155.

<sup>34</sup> See AER, *Draft Guidance Note – Guidance Note on insurance coverage pass through event*, February 2021, p. 4.

<sup>35</sup> AusNet Services, *Revised regulatory proposal 2022–26*, December 2020, p. 153.

<sup>36</sup> NER, cll. 6.6.1 (a)-(b).

<sup>37</sup> Jemena, *Revised regulatory proposal 2022–26 - Att 08-01*, December 2020, p. 5.

<sup>38</sup> AusNet Services, *Revised regulatory proposal 2022–26*, December 2020, pp. 156–159.

<sup>39</sup> AusNet Services, *Revised regulatory proposal 2022–26*, December 2020, pp. 156–159.

into account the NER considerations for a nominated cost pass through event.<sup>40</sup> In assessing AusNet Services' proposal, we have had regard to each of the nominated pass through event considerations.

Generally, we consider that cost pass through events should be the last option available for network businesses to recover costs in order to protect the incentive mechanisms of our framework.<sup>41</sup> As set out above in our assessment approach, the NER cost pass through framework is intended to ensure pass through events should only be accepted when it is the least inefficient option and event avoidance, mitigation and insurance are found to be inappropriate.<sup>42</sup>

In this regard, our view on balance is that in the current circumstances while there is some uncertainty associated with forecasting insurance premium increases, under our incentive based framework, businesses are best incentivised to achieve efficient cost outcomes by including these in the total opex forecast for the 2021–26 regulatory control period.

As set out in Attachment 6, section 6.4.3.4, the forecasts available to us take into account additional information that AusNet Services provided from its insurance brokers (AON) about future premium increases, as well as our consultant's (Taylor Fry) review of these forecasts.<sup>43</sup> We consider that including future premium increases in the opex forecast for the 2021–26 regulatory control period incentivises AusNet Services to continue to do all it can to try to manage and mitigate future increases in insurance premium increases, including by managing risks associated with insurance liability, especially for bushfires. This is consistent with our ex-ante incentive-based regulatory framework. Any measure to diminish this incentive, such as the use of a cost pass through, would work counter to this regime.

We acknowledge there are benefits of using a cost pass through for businesses to recover insurance premium costs over the next regulatory control period, including as raised in some submissions. These include that a cost pass through lessens the need to set a forecast when there is significant uncertainty and customers only pay for higher costs when they are known during the period. However, we consider on balance that the long term interests of consumers is better served if the appropriate incentives remain with the businesses to actively work to moderate expected increases in insurance premiums over the next regulatory control period.

For the reasons set out above, we have not accepted AusNet Services' proposed insurance premium event nominated cost pass through for the 2021–26 regulatory control period.

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<sup>40</sup> NER, cl. 6.5.10 (b).

<sup>41</sup> AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. i.

<sup>42</sup> AEMC, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 20.

<sup>43</sup> Taylor Fry, *AER AusNet Services Bushfire Insurance Public summary*, March 2021.

The above discussion and decision on the insurance premiums pass through event should be read in conjunction with our final decision on the insurance premiums step change in Attachment 6 of this final decision, section 6.4.3.4.

### 15.5.4 Major Cyber event

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

AusNet Services' revised proposal included a new pass through event for major cyber events based on its view that cyber events may fall outside the terrorism event definition and/or the inability to determine motivation of the perpetrators of a major cyber-attack.<sup>44</sup>

In their submissions, the EUAA and ECA's consultant Spencer and Co did not support a major cyber event being a nominated cost pass through given it covers costs associated with a non-terrorism event.<sup>45</sup>

We accept that the occurrence of major cyber events, as defined, cannot be completely ruled out. One of the key factors under the NER nominated cost pass through considerations is whether a prudent service provider could reasonably prevent an event of that nature or type from occurring or substantially mitigate the cost impact of such an event.<sup>46</sup> We consider it is appropriate for network service providers to be incentivised to mitigate the risk of major cyber events occurring, and also to mitigate the extent of damage that may be caused by them and any impact on the provision of direct control services.

If we were to accept this pass through event, the incentive on AusNet Services and other service providers to proactively manage cyber security risks and adopt best practices would likely be significantly reduced. Although AusNet Services has no control on what third parties do, it controls the cyber security and protection of its ICT systems and assets, which affects its susceptibility to cyber-attacks and the likelihood of a major cyber event. AusNet Services has a regulatory obligation to maintain the security of supply of electricity and an incentive to ensure the security of its network systems is sufficiently robust and resilient to withstand cyber-threats such that a major interruption to its technology systems and assets would not occur. We consider AusNet Services can substantially mitigate the risk and cost impact of this type of event in a forward looking manner by ensuring appropriate cyber-security protections are in place and having appropriate contingency precautions.

Our recent decisions for other distributors to not accept a major cyber event are because we consider cyber security risk is one of the key business risks an energy

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<sup>44</sup> AusNet Services, *Revised regulatory proposal 2022–26*, December 2020, pp. 163–167.

<sup>45</sup> EUAA, *Submission on the Victorian EDPR Revised Proposal and draft decision 2021–26*, January 2021, p.11; ECA, *Submission on the Victorian EDPR Revised Proposal and draft decision 2021–26*, January 2021, p. 19 (Spencer&Co).

<sup>46</sup> NER, Chapter 10, *Nominated pass through event considerations* (c).

network service provider faces.<sup>47</sup> This risk should be largely borne by the network service provider, who is best placed to manage it, rather than consumers.<sup>48</sup> We consider accepting the broadly defined proposed major cyber event is likely to have the effect of passing AusNet Services' cyber-security risk to consumers and erode its incentives to manage this risk efficiently and prudently.

Our recent decisions also emphasised that all Australian utility providers operate national critical infrastructure and are subject to stringent cyber security compliance requirements.<sup>49</sup> We expect AusNet Services would have appropriate safeguards or contingency plans to substantially mitigate the risks and cost impacts of major cyber-attacks. Supporting this, our draft decision assessed AusNet Services' estimate of total capital expenditure, including the cyber security information and communications technology capital expenditure that it proposed.<sup>50</sup> This expenditure is intended for AusNet Services to strengthen its capability to proactively identify, protect, detect, respond to and recover from cyber security threats.

We have also noted in our previous decisions for other distributors that the nominated 'terrorism' pass through event could include cyber-terrorism.<sup>51</sup>

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

### 15.5.5 Environment protection event

Our final decision is to not accept the environment protection event proposed by AusNet Services.

AusNet Services proposed this new nominated environment protection event because it considered the costs it may incur under the new obligations of the *Environment Protection Amendment Act 2018* (Vic) are uncertain and may result in it not being able to recover its efficient costs.<sup>52</sup>

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<sup>47</sup> AER, *Draft decision CitiPower Distribution Determination 2021 to 2026 - Attachment 15 Pass through events*, September 2020, pp.17-19.

<sup>48</sup> AER, *Draft decision CitiPower Distribution Determination 2021 to 2026 - Attachment 15 Pass through events*, September 2020, pp.17-19.

<sup>49</sup> AER, *Draft decision CitiPower Distribution Determination 2021 to 2026 - Attachment 15 Pass through events*, September 2020, pp.17-19.

<sup>50</sup> AER, *Draft decision AusNet Services Distribution Determination 2021–26, Attachment 5 Capital expenditure*, September 2020. pp. 27-28.

<sup>51</sup> AER, *Final decision, CitiPower Distribution Determination 2016–20, Attachment 15 Pass through events*, May 2016, pp. 19–20; AER, *Draft decision, Essential Energy distribution determination 2019–24, Attachment 14 Pass through events*, November 2018, pp.13–14.

<sup>52</sup> AusNet Services, *Revised regulatory proposal 2022–26*, December 2020, pp. 162–163.



Consumer groups such as the CCP17 and VCO questioned the need for the proposed environmental protection event, given the apparent duplication with the existing prescribed regulatory change event in the NER.<sup>53</sup>

We do not consider AusNet Services' has provided a clear justification as to why regulatory obligations arising under the *Environment Protection Amendment Act 2018* (Vic) should be subject to an additional nominated pass through event. Our view is that the proposed environment protection event is already covered by the prescribed regulatory change event in the NER. While there are some additional matters set out in the proposed definitions of AusNet Services' nominated pass through event, which are not features of the prescribed regulatory change event definition in the NER, it appears there is nothing that would preclude the proposed new obligations of the *Environment Protection Amendment Act 2018* (Vic) from being covered by the prescribed regulatory change event.

The nominated pass through event considerations in the NER require the AER to consider whether a proposed nominated event is covered by a category of pass through event specified in the NER.<sup>54</sup> We consider that the proposed environment protection event is an event covered by a category of pass through event specified in clause 6.6.1(a1)(1) to(4), specifically the prescribed "regulatory change" event. Therefore, our final decision is to not accept the environment protection pass through event proposed by AusNet Services.

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<sup>53</sup> CCP17, *Submission on the Victorian EDPR Revised Proposal and draft decision 2021–26*, January 2021, p. 69; Headberry Partners report to VCO, *Submission on the Victorian EDPR Revised Proposal and draft decision 2021–26*, January 2021, p. 28-29, 66.

<sup>54</sup> NER, Chapter 10, *Nominated pass through event considerations* (a).



**Table 15.2 Approved cost pass through definitions**

Pass through event	Approved definition
Insurance coverage	<p>An insurance coverage event occurs if:</p> <ol style="list-style-type: none"> <li>1. AusNet Services:           <ol style="list-style-type: none"> <li>a) makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy or set of insurance policies; or</li> <li>b) would have been able to make a claim or claims under a relevant insurance policy or set of insurance policies but for changed circumstances; and</li> </ol> </li> <li>2. AusNet Services incurs costs:           <ol style="list-style-type: none"> <li>a) beyond a relevant policy limit for that policy or set of insurance policies; or</li> <li>b) that are unrecoverable under that policy or set of insurance policies due to changed circumstances; and</li> </ol> </li> <li>3. The costs referred to in paragraph 2 above materially increase the costs to AusNet Services in providing direct control services.</li> </ol> <p>For the purposes of this insurance coverage event:</p> <p>'changed circumstances' means movements in the relevant insurance liability market that are beyond the control of AusNet Services, where those movements mean that it is no longer possible for AusNet Services to take out an insurance policy or set of insurance policies at all or on reasonable commercial terms that include some or all of the costs referred to in paragraph 2 above within the scope of that insurance policy or set of insurance policies.</p> <p>'costs' means the costs that would have been recovered under the insurance policy or set of insurance policies had:</p> <ol style="list-style-type: none"> <li>i. the limit not been exhausted; or</li> <li>ii. those costs not been unrecoverable due to changed circumstances.</li> </ol> <p>A relevant insurance policy or set of insurance policies is an insurance policy or set of insurance policies held during the regulatory control period or a previous regulatory control period in which AusNet Services was regulated; and</p> <p>AusNet Services will be deemed to have made a claim on a relevant insurance policy or set of insurance policies if the claim is made by a related party of AusNet Services in relation to any aspect of AusNet Services' network or business; and</p>

Pass through event	Approved definition
	<p>AusNet Services will be deemed to have been able to make a claim on a relevant insurance policy or set of insurance policies if, but for changed circumstances, the claim could have been made by a related party of AusNet Services in relation to any aspect of AusNet Services' network or business.</p> <p>Note for the avoidance of doubt, in assessing an insurance coverage event through application under rule 6.6.1(j), the AER will have regard to:</p> <ul style="list-style-type: none"> <li>i. the relevant insurance policy or set of insurance policies for the event</li> <li>ii. the level of insurance that an efficient and prudent DNSP would obtain, or would have sought to obtain, in respect of the event;</li> <li>iii. any information provided by AusNet Services to the AER about AusNet Services' actions and processes; and</li> <li>iv. any guidance published by the AER on matters the AER will likely have regard to in assessing any insurance coverage event that occurs.</li> </ul>
Insurer credit risk	<p>An insurer credit risk event occurs if an insurer of AusNet Services becomes insolvent, and as a result, in respect of an existing or potential claim for a risk that was insured by the insolvent insurer, AusNet Services:</p> <ul style="list-style-type: none"> <li>(a) is subject to a higher or lower claim limit or a higher or lower deductible than would have otherwise applied under the insolvent insurer's policy; or</li> <li>(b) incurs additional costs associated with funding an insurance claim, which would otherwise have been covered by the insolvent insurer.</li> </ul> <p>Note: in assessing an insurer credit risk event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> <li>i. AusNet Services' attempts to mitigate and prevent the event from occurring by reviewing and considering the insurer's track record, size, credit rating and reputation; and</li> <li>ii. in the event that a claim would have been covered by the insolvent insurer's policy, whether AusNet Services had reasonable opportunity to insure the risk with a different provider.</li> </ul>
Natural disaster	<p>Natural disaster event means any natural disaster including but not limited to cyclone, fire, flood or earthquake that occurs during the 2021–26 regulatory control period that</p>

Pass through event	Approved definition
	<p>changes the costs to AusNet Services in providing direct control services, provided the cyclone, fire, flood, earthquake or other event was:</p> <p>(a) a consequence of an act or omission that was necessary for the service provider to comply with a regulatory obligation or requirement or with an applicable regulatory instrument; or</p> <p>(b) not a consequence of any other act or omission of the service provider.</p> <p>Note: In assessing a natural disaster event pass through application, the AER will have regard to, amongst other things:</p> <p>(1) whether AusNet Services has insurance against the event;</p> <p>(2) the level of insurance that an efficient and prudent NSP would obtain in respect of the event.</p>
Terrorism	<p>Terrorism event means an act (including, but not limited to, the use of force or violence or the threat of force or violence) of any person or group of persons (whether acting alone or on behalf of or in connection with any organisation or government), which:</p> <p>from its nature or context is done for, or in connection with, political, religious, ideological, ethnic or similar purposes or reasons (including the intention to influence or intimidate any government and/or put the public, or any section of the public, in fear); and</p> <p>changes the costs to AusNet Services in providing direct control services.</p> <p>Note: In assessing a terrorism event pass through application, the AER will have regard to, amongst other things:</p> <p>i. whether AusNet Services has insurance against 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. whether a declaration has been made by a relevant government authority that a terrorism event has occurred.</p>
Retailer insolvency	<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>

Pass through event	Approved definition
	<p>(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</p> <p>(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).</p> <p>For the purposes of this definition, the terms 'eligible pass through amount' and 'positive change event' where they appear in the NER (as well as any subordinate terms including, without limitation, 'retailer insolvency costs', 'failed retailer' and 'billed but unpaid charges') 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 Customer Framework in Victoria</p>

Source: AER analysis

## Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
CCP17	Consumer Challenge Panel, sub-panel 17
distributor	distribution network service provider
DNSP	distribution network service provider
ECA	Energy Consumers Australia
NEL	National Electricity Law
NEO	National Electricity Objective
NER	National Electricity Rules
NSP	network service provider
opex	operating expenditure
VCO	Victorian Community Organisations