



DRAFT DECISION

SA Power Networks Distribution Determination 2020 to 2025

Attachment 14 Pass through events

October 2019

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Note

This attachment forms part of the AER's draft decision on the distribution determination that will apply to SA Power Networks for the 2020–2025 regulatory control period. It should be read with all other parts of the draft decision.

The draft 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

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 11 – Demand management incentive scheme

Attachment 12 – Classification of services

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Attachment 14 – Pass through events

Attachment 15 – Alternative control services

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Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
capex	capital expenditure
distributor	distribution network service provider
DUoS	distribution use of system
NEL	national electricity law
NEO	national electricity objective
NER or the rules	national electricity rules
NSP	network service provider
opex	operating expenditure
RPP	revenue and pricing principles

14 Cost pass through events

During the regulatory control period SA Power Networks can apply to pass through to its customers, in the form of higher or lower network charges, certain material changes in its costs caused by pre-defined exogenous events. These events are called cost pass through events. 'Positive' pass throughs allow SA Power Networks to recover the efficient costs incurred as a result of events that could not be forecast as part of its proposal that otherwise would have a significant financial effect on its ability to invest in and operate its network.¹

The National Electricity Rules (NER) prescribe the following pass through events for all distribution determinations:²

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

In addition to these prescribed events, other pass through events may be 'nominated' by a service provider for a regulatory control period.³ This attachment sets out our draft decision on the nominated pass through events to apply to SA Power Networks' distribution network for the 2020–25 regulatory control period.

14.1 Draft decision

Our draft decision pursuant to clause 6.12.1(14) of the NER is as follows:

- We accept four of SA Power Networks' proposed nominated pass through events (terrorism, natural disaster, insurance cap and insurer's credit risk event)
- We do not accept SA Power Networks' proposed 'major cyber' pass through event.

Our draft decision sets out minor amendments to the definitions of the terrorism, natural disaster, insurance cap and insurer's credit risk pass through events, to provide consistency between SA Power Networks and other network service providers.⁴ Also, we have included an additional factor we will have regard to when assessing whether a

¹ AEMC 2012, Cost pass through arrangements for Network Service Providers, Rule Determination, 2 August 2012, p. 2.

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

³ NER, cl. 6.6.1(a1)(5).

⁴ E.g. AER, *Draft Decision, Ausgrid distribution determination 2019–24, Attachment 14 Pass through events*, November 2018, pp. 12–13; AER, *Draft Decision, Essential Energy distribution determination 2019–24, Attachment 14 Pass through events*, November 2018, pp. 11–13; AER, *Draft Decision, Ergon Energy distribution determination 2020–25, Attachment 14 Pass through events*, October 2019, pp. 11–13; AER, *Draft Decision, Energex distribution determination 2020–25, Attachment 14 Pass through events*, October 2019, pp. 11–13.

pass through event has occurred in our definition of 'terrorism' event. Our amended definitions are set out in Table 14.2.

SA Power Networks also noted it may need to propose an additional pass through event depending on the implementation of the recommendations in the AER's final report on the review of the regulatory tax approach.⁵ Further that it would update the AER as soon as it has a concluded view on these issues. We have not received any additional information from SA Power Networks about this potential additional cost pass through and have not considered it as a part of this draft decision.

14.2 SA Power Networks' proposal

SA Power Networks' proposed nominated pass through events are set out in Table 14.1.⁶

Table 14.1 SA Power Networks' nominated pass through events

Pass through event	SA Power Networks' proposed definition
Insurance cap	<p>An insurance cap event occurs if:</p> <ul style="list-style-type: none"> SA Power Networks makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy, SA Power Networks incurs costs beyond the relevant policy limit, and The costs beyond the relevant policy limit materially increase the costs to SA Power Networks in providing direct control services. <p>For this insurance cap event:</p> <ul style="list-style-type: none"> a relevant insurance policy is an insurance policy held during the 2020–25 regulatory control period or a previous regulatory control period in which SA Power Networks was regulated; and SA Power Networks will be deemed to have made a claim on a relevant insurance policy if the claim is made by a related party of SA Power Networks in relation to any aspect of SA Power Networks' network or business. <p>Note for the avoidance of doubt, in assessing an insurance cap event through application under rule 6.6.1(i), the AER will have regard to:</p> <ul style="list-style-type: none"> the relevant insurance policy for the event, and the level of insurance that an efficient and prudent NSP would obtain in respect of the event.
Insurer credit risk	<p>An insurer credit risk event occurs if an insurer of SA Power Networks becomes insolvent, and as a result, in respect of an existing or potential claim for a risk that was insured by the insolvent insurer, SA Power Networks:</p> <ul style="list-style-type: none"> 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 Incurs additional costs associated with funding an insurance claim,

⁵ SA Power Networks, *2020–25 Regulatory Proposal – Attachment 13 – Pass through events*, January 2019, p. 12.

⁶ SA Power Networks, *2020–25 Regulatory Proposal – Attachment 13 – Pass through events*, January 2019.

Pass through event	SA Power Networks' proposed definition
	<p>which would otherwise have been covered by the insolvent insurer.</p> <p>Note: in assessing an insurer credit risk event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> SA Power Networks' attempts to mitigate and prevent the event from occurring by reviewing and considering the insurer's track record, size, credit rating and reputation prior to taking out the relevant insurance policy; and in the event that a claim would have been covered by the insolvent insurer's policy, whether SA Power Networks had reasonable opportunity to insure the risk with a different provider.
<p>Natural disaster</p>	<p>Natural disaster event means any natural disaster (including but not limited to cyclone, fire, flood or earthquake) that occurs during the 2020–25 regulatory control period that increases the costs to SA Power Networks in providing direct control services, provided the fire, flood or other event was not a consequence of the negligent acts or omissions 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> <ul style="list-style-type: none"> whether SA Power Networks has insurance against the event; the level of insurance that an efficient and prudent NSP would obtain in respect of the event; and whether a relevant government authority has made a declaration that a natural disaster has occurred.
<p>Terrorism</p>	<p>Terrorism event means an act (including, but not limited to, the use of force or violence or the threat of force or violence) of any person or group of persons (whether acting alone or on behalf of or in connection with any organisation or government), which:</p> <ul style="list-style-type: none"> 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 increases the costs to SA Power Networks in providing direct control services. <p>Note: In assessing a terrorism event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> whether SA Power Networks has insurance against the event; and the level of insurance that an efficient and prudent NSP would obtain in respect of the event.
<p>Major cyber</p>	<p>'Major cyber event' means a major interruption to the technology systems or assets used by SA Power Networks to provide direct control services occurring during the 2020–25 regulatory control period that materially increases the costs to SA Power Networks in providing direct control services, provided that:</p> <ul style="list-style-type: none"> the interruption was caused by an act of a third party; and the event does not constitute a 'terrorism event'. <p>Note: In assessing a major cyber event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> whether SA Power Networks has insurance against the event; the level of insurance that an efficient and prudent DNSP would obtain

Pass through event	SA Power Networks' proposed definition
	<p>in respect of the event;</p> <ul style="list-style-type: none"> whether the steps taken by SA Power Networks to prevent the event from occurring are consistent with the steps that an efficient and prudent DNSP would have taken in the circumstances to prevent the occurrence of the event; and whether the steps taken by SA Power Networks to mitigate the cost impact of the event are consistent with the steps that an efficient and prudent DNSP would have taken in the circumstances to mitigate the cost impact of the event.

14.3 Assessment approach

The NER set out how we must assess nominated pass through events, and how we must assess an application from a service provider to pass through changes in costs where an event occurs.⁷

Our assessment approach is guided by the National Electricity Objective (NEO) and the Revenue and Pricing Principles (RPPs).⁸ The RPPs include that the service provider should have a reasonable opportunity to recover at least the efficient costs of providing services and complying with regulatory obligations.⁹ The NEO and the RPPs also reflect the importance of incentives to promote economic efficiency,¹⁰ and balance the risks of under and over investment.¹¹

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.¹²

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:¹³

- 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);

⁷ NER, cl. 6.5.10(b), 6.6.1.

⁸ NEL, ss. 7 and 7A.

⁹ NEL, s. 7A(2).

¹⁰ NEL, s. 7A(3).

¹¹ NEL, s. 7A(6).

¹² AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 6.

¹³ 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.¹⁴

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.¹⁵

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.¹⁶ This promotes the efficient investment in, and efficient operation and

¹⁴ AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 19.

¹⁵ AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 20.

¹⁶ AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 8.

use of, network services for the long term interests of consumers with respect to price.¹⁷

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.¹⁸

14.4 Interrelationships

The pass through mechanism is not the only way service providers can manage their risks under a distribution or transmission determination. It is interrelated with other parts of this decision, in particular with the forecast operating and capital expenditure (opex and capex) and rate of return included in our revenue determination. We must specify and take account of these interrelationships.¹⁹ This requires us to balance the incentives in the various parts of our decision.

For systemic risks, service providers are compensated through the allowed rate of return. Service providers also face business-specific, or residual, risks. Service providers are compensated for the prudent and efficient management of these risks through the forecast opex and capex we include in our revenue determination for strategies such as:

- prevention (avoiding the risk)
- mitigation (reducing the probability and impact of the risk)
- insurance (transferring the risk to another party)
- self-insurance (putting aside funds to manage the likely costs associated with a risk event).

An efficient business will manage its risk by employing the most cost effective combination of these strategies. In order to maintain appropriate incentives under our determinations, we only accept nominated pass through events where we are satisfied that event avoidance, mitigation, commercial insurance and self-insurance under approved forecasts of prudent and efficient opex and capex are either unavailable or inappropriate.²⁰

In general, in respect of unforeseen costs that are relatively minor, a service provider should manage them by using up its existing expenditure allowance, or reprioritising or substituting its projects, to avoid seeking cost recovery through the pass through

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

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

¹⁹ NEL, s. 16(1)(c).

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

mechanisms.²¹ This is reflected in the materiality threshold that applies to cost pass through applications.²²

Cost pass through amounts approved in a regulatory control period are added to (or in the case of a negative pass through deducted from) forecast opex and capex for the purpose of calculating efficiency carryover amounts under the Efficiency Benefit Sharing Scheme and Capital Expenditure Sharing Scheme.²³

Any capex that has already been recovered in a regulatory control period by way of a cost pass through cannot be recovered again in the roll-forward of the regulatory asset base for the next regulatory control period.²⁴

14.5 Reasons for draft decision

14.5.1 Insurance cap, insurer's credit risk, natural disaster and terrorism events

Consistent with our recent decisions in regard to other network service providers,²⁵ we consider four of SA Power Networks' proposed nominated pass through events (terrorism, natural disaster, insurer's credit risk, insurance cap) meet the nominated pass through event considerations set out in the NER.²⁶

- the proposed events are not covered by an existing category of pass through event
- the nature of the events are clearly identifiable at this time
- a prudent service provider could not reasonably prevent an event of that nature or type from occurring or substantially mitigate its cost impact, and could not insure (or self-insure) against the events on reasonable commercial terms.

With regard to the latter point, while SA Power Networks could take steps to reduce its risk exposure to these events, expenditure beyond a certain level aimed at completely eliminating the risk is likely to be imprudent or inefficient. In that context, sharing the risk between SA Power Networks and its customers is appropriate and more likely to be in the long-term interests of consumers with respect to price.

²¹ AEMC 2012, *Economic Regulation of Network Service Providers, and Price and Revenue Regulation of Gas Services, Final Position Paper*, 29 November 2012, p. 186.

²² NER, Chapter 10: Glossary, definition of 'materially'.

²³ AER, *Efficiency Benefit Sharing Scheme for Electricity Network Service Providers*, November 2013, p. 7; AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013, p. 6.

²⁴ NER, cl. S6.2.1(e)(1)(ii).

²⁵ E.g. AER, *Draft Decision, Ausgrid distribution determination 2019–24, Attachment 14 Pass through events*, November 2018, pp. 12–13; AER, *Draft Decision, Essential Energy distribution determination 2019–24, Attachment 14 Pass through events*, November 2018, pp. 11–13; AER, *Draft Decision, Ergon Energy distribution determination 2020–25, Attachment 14 Pass through events*, October 2019, pp. 11–13; AER, *Draft Decision, Energex distribution determination 2020–25, Attachment 14 Pass through events*, October 2019, pp. 11–13.

²⁶ NER, cl. 6.5.10(b); Chapter 10: Glossary, definition of 'nominated pass through event considerations'.

We have made some minor amendments to the definitions of these approved nominated pass through events to provide greater drafting consistency between SA Power Networks and other network service providers, as set out in Table 14.2. Also, we have included an additional factor of consideration in our definition of 'terrorism' event.

Definition of 'terrorism' event

Our definition of 'terrorism' event is largely the same as SA Power Networks' proposed definition. However, we have included an additional factor which we will have regard to when assessing whether a pass through event has occurred in our definition of the 'terrorism' event, namely:

Whether a declaration has been made by a relevant government authority that a terrorism event has occurred.

The inclusion of this factor is consistent with our previous decisions for other distribution businesses.²⁷ By specifying the factors that we would consider relevant to a nominated pass through event within its definition, this provides greater transparency and certainty in any assessment of the nominated pass through event. We consider the views of appropriate government bodies are relevant in determining whether an event can be defined as terrorism. As explained in our final decision for CitiPower's 2016–20 distribution determination:²⁸

a declaration (by a government authority) or otherwise is not determinative of whether an occurrence is within the scope of the terrorism event. It may not be straightforward to distinguish between an act of terrorism and a bare crime, particularly since the motivation and intent of the perpetrators are key elements. As such, we are justified in having regard to the deliberations of government authorities with responsibilities and expertise in this field in relation to the occurrence of an act of terrorism.

Table 14.2 AER pass through event definitions

Pass through event	Approved definition
Insurance cap	<p>An insurance cap event occurs if:</p> <ul style="list-style-type: none"> • SA Power Networks makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy, • SA Power Networks incurs costs beyond the relevant policy limit, and • the costs beyond the relevant policy limit materially increase the costs

²⁷ E.g. AER, *Final decision, CitiPower distribution determination 2016–20, Attachment 15 Pass through events*, May 2016; AER, *Draft Decision, Ausgrid distribution determination 2019–24, Attachment 14 Pass through events*, November 2018; AER, *Draft Decision, Essential Energy distribution determination 2019–24, Attachment 14 Pass through events*, November 2018.

²⁸ AER, *Final decision, CitiPower distribution determination 2016–20, Attachment 15 Pass through events*, May 2016, p. 20.

Pass through event	Approved definition
	<p>to SA Power Networks in providing direct control services.</p> <ul style="list-style-type: none"> • For this insurance cap event: <ul style="list-style-type: none"> ○ A relevant insurance policy is an insurance policy held during the 2020-25 regulatory control period or a previous regulatory control period in which SA Power Networks was regulated ○ SA Power Networks will be deemed to have made a claim on a relevant insurance policy if the claim is made by a related party of SA Power Networks in relation to any aspect of the network or SA Power Networks' business. • Note: In assessing an insurance cap event cost pass through application under rule 6.6.1(j), the AER will have regard to, amongst other things: <ul style="list-style-type: none"> ○ the relevant insurance policy for the event, and ○ the level of insurance that an efficient and prudent NSP would obtain in respect of the event.
Insurer credit risk	<p>An insurer credit risk event occurs if:</p> <ul style="list-style-type: none"> • An insurer of SA Power Networks becomes insolvent, and as a result, in respect of an existing or potential claim for a risk that was insured by the insolvent insurer, SA Power Networks: <ul style="list-style-type: none"> ○ 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 ○ incurs additional costs associated with funding an insurance claim, which would otherwise have been covered by the insolvent insurer. <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"> • SA Power Networks' attempts to mitigate and prevent the event from occurring by reviewing and considering the insurers track record, size, credit rating and reputation, and • in the event that a claim would have been made after the insurer became insolvent, whether SA Power Networks had reasonable opportunity to insure the risk with a different insurer.
Natural disaster	<p>Natural disaster event means any natural disaster including but not limited to cyclone, fire, flood or earthquake that occurs during the 2020–25 regulatory control period that increases the costs to SA Power Networks in providing direct control services, provided the fire, flood or other event was not a consequence of the acts or omissions of the service provider.</p> <p>Note: In assessing a natural disaster event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> • whether SA Power Networks has insurance against the event, • the level of insurance that an efficient and prudent NSP would obtain in respect of the event, and • whether a relevant government authority has made a declaration that a natural disaster has occurred.
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> <ul style="list-style-type: none"> • from its nature or context is done for, or in connection with, political,

Pass through event	Approved definition
	<p>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> <ul style="list-style-type: none"> increases the costs to SA Power Networks in providing direct control services. <p>Note: In assessing a terrorism event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> whether SA Power Networks has insurance against the event, the level of insurance that an efficient and prudent NSP would obtain in respect of the event, and whether a declaration has been made by a relevant government authority that a terrorism event has occurred.

14.5.2 Major cyber event

Our draft decision is to reject SA Power Networks' proposed 'major cyber' event having regard to the nominated pass through event considerations. This is consistent with our recent pass through event decision with respect to Essential Energy's 2019–24 regulatory determination.²⁹

Our draft decision does not mean that SA Power Networks would not be able to seek a cost pass through for cyber-attacks in any event. We noted in our previous decision for other distributors that the nominated 'terrorism' pass through event could include cyber-terrorism.³⁰

SA Power Networks defines a 'major cyber' event as:³¹

a major interruption to the technology systems or assets used by SA Power Networks to provide direct control services occurring during the 2020–25 regulatory control period that materially increases the costs to SA Power Networks in providing direct control services, provided that:

- the interruption was caused by an act of a third party; and
- the event does not constitute a 'terrorism event'.

While we consider a 'major cyber' event as defined by SA Power Networks is not covered by a category of pass through event, and that this type of event can be clearly identified, we are not satisfied that SA Power Networks could not mitigate the risk of a 'major cyber' event from occurring or substantially mitigate its cost impact. We also do not consider SA Power Networks has provided sufficient evidence that commercial

²⁹ AER, *Draft decision - Essential Energy distribution determination 2019–24, Attachment 14 Pass through events*, November 2018, pp.13–14.

³⁰ AER, *Final decision, CitiPower distribution determination 2016–20, Attachment 15 Pass through events*, May 2016, pp. 18–20; AER, *Draft decision - Essential Energy distribution determination 2019–24, Attachment 14 Pass through events*, November 2018, pp.13–14.

³¹ SA Power Networks, *2020–25 Regulatory Proposal – Attachment 13 – Pass through events*, January 2019, p. 11.

insurance and self-insurance are unavailable. To preserve the incentives on SA Power Networks to invest efficiently in its system to guard against cyber-security threats, we have to be satisfied that market-based mechanisms such as insurance and risk mitigation strategies are unavailable or inappropriate before accepting it as a nominated cost pass through event.

In its proposal, SA Power Networks stated that it cannot prevent a major cyber event from occurring and cannot substantially mitigate the cost impacts of this type of event.³² SA Power Networks operates national critical infrastructure and is subject to stringent cyber security compliance requirements. We consider it unrealistic that SA Power Networks would have no appropriate safeguards or contingency plans to substantially mitigate the risks and cost impacts of major cyber-attacks.

Supporting this, we have included in our capital expenditure forecast for this draft decision information and communications technology (ICT) capital expenditure that SA Power Networks proposed. This expenditure is intended for SA Power Networks to strengthen its capability to proactively identify, protect, detect, respond to and recover from cyber security threats.³³ Further, our draft decision includes an opex step change of \$12.1 million (\$2019–20) for critical infrastructure compliance.³⁴ As noted by SA Power Networks, the new critical infrastructure obligations it faces mean it needs to use ICT systems and support arrangements that are based within Australia.³⁵ These new obligations in part go to managing the cyber security risks associated with operating SA Power Networks' distribution network.

Cyber security risk is one of the key business risks an energy network service provider faces and we consider this business risk should be borne by the network service provider, who is best placed to manage it, rather than consumers. We consider that approving SA Power Networks' proposed 'major cyber' event will have the effect of passing SA Power Networks' cyber-security risk to consumers and erode its incentives to manage this risk efficiently and prudently.

We accept that the occurrence of major cyber events, as defined, cannot be completely ruled out. We consider it is appropriate that network service providers 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 this pass through event were accepted, the incentive on SA Power Networks and other service providers to proactively manage cyber security risks and adopt best practices would likely be significantly reduced.

Although SA Power Networks has no control on what third parties do, it controls the cyber security and protection of its ICT systems and assets, which affects its

³² SA Power Networks, *2020–25 Regulatory Proposal – Attachment 13 – Pass through events*, January 2019, p. 11.

³³ AER, *Draft decision - SA Power Networks distribution determination 2020–25, Attachment 5 Capital Expenditure*, October 2019, Section A.6.

³⁴ AER, *Draft decision - SA Power Networks distribution determination 2020–25, Attachment 6 Operating Expenditure*, October 2019, p.41.

³⁵ SA Power Networks, *2020–25 Regulatory Proposal – Attachment 6– Operating expenditure*, January 2019, p 27.

susceptibility to cyber-attacks and the likelihood of a 'major cyber' event. SA Power Networks 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 SA Power Networks 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.

SA Power Networks stated that it has addressed the considerations above by including in the definition of its proposed 'major cyber' event the following assessment factors:³⁶

whether the steps taken by SA Power Networks to prevent the event from occurring are consistent with the steps that an efficient and prudent DNSP would have taken in the circumstances to prevent the occurrence of the event; and

whether the steps taken by SA Power Networks to mitigate the cost impact of the event are consistent with the steps that an efficient and prudent DNSP would have taken in the circumstances to mitigate the cost impact of the event.

SA Power Network has not properly addressed the nominated pass through event considerations, nor our view that cyber-security risk is a business risk that a network service provider should manage. Including the proposed assessment factors set out above in the definition of the 'major cyber' event does not in fact address the considerations. Instead, it conflates the assessment of whether we should accept a nominated pass through event under clause 6.5.10(b) of the NER and the assessment of a pass through event under clause 6.6.1(j) of the NER.

Also, with no supporting evidence, SA Power Networks has stated that it:³⁷

cannot obtain appropriate insurances on reasonable commercial terms covering the full range of costs that could potentially be incurred as a result of the occurrence of this type of event.

We are not satisfied that SA Power Networks has sufficiently demonstrated the lack of cyber insurance against this type of event on reasonable commercial terms or that the self-insurance premiums are prohibitive.

³⁶ SA Power Networks, *2020–25 Regulatory Proposal – Attachment 13 – Pass through events*, January 2019, p. 11.

³⁷ SA Power Networks, *2020–25 Regulatory Proposal – Attachment 13 – Pass through events*, January 2019, p. 11.