

Determination

October 2021 storm cost pass through

AusNet Services

June 2022

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Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001
Tel: 1300 585 165

AER reference: 13783902

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Overview

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

On 10 March 2022, AusNet Services submitted a cost pass through application (AusNet Services' application) seeking to recover actual costs it experienced as a result of the storms that occurred on 29 October 2021 (October 2021 storm) in Victoria. AusNet Services stated that the October storm caused extensive damage to AusNet Services' electricity distribution network and interrupted supply to over 230,000 customers.¹

AusNet Services is seeking to recover \$6.12 million (\$nominal, smoothed)² in incremental revenue over the 2021–26 regulatory control period.

Under the National Electricity Rules (NER), AusNet Services is able seek the approval of the Australian Energy Regulator (AER), to pass through to network users a positive pass through amount in respect of certain events (referred to in the NER as positive change events).³ A cost pass through application must address specified matters.⁴

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 (within a specified timeframe):

- 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.⁵

On 29 March 2022, we published AusNet Services' application on our website and invited stakeholder submissions. We did not receive any stakeholder submissions.

This determination sets out our assessment of AusNet Services' application and addresses the requirements, as set out in clause 6.6.1 of the NER.

We are satisfied that the October 2021 storm event meets the definition of a natural disaster pass through event. Based on our consideration of the factors set out in clause 6.6.1(j) of the NER, we determine to allow the pass through of the costs proposed by AusNet Services in

¹ AusNet Services, *AusNet Services - October 2021 Storm cost pass through - Application - March 2022*. p 9.

² This is equivalent to \$5.7 million (\$2020–21, smoothed) as reflected in AusNet Services' cost pass through application.

³ NER, cl. 6.6.1(a). A positive change event is: (a) a pass through event, other than a retailer insolvency event, which entails the Distribution Network Service Provider incurring materially higher costs in providing direct control services than it would have incurred but for that event, but does not include a contingent project or an associated trigger event; or (b) a retailer insolvency event. A pass through event is those events specified in clause 6.6.1(a1).

⁴ NER, cl. 6.6.1(c).

⁵ NER, cl. 6.6.1(d).

its October 2021 storm cost pass through application. However, we adjusted AusNet Services' proposed cost pass through amount to correct for an error it made by removing the reduction in vegetation management opex costs twice. This adjustment increased the cost pass through amount from \$6.12 million (\$nominal) to \$6.17 million (\$nominal). AusNet Services' has agreed to this amendment.

We are satisfied that the materiality threshold to constitute a positive change event has been met and that the costs incurred by AusNet Services as a direct result of the October 2021 storm were prudent and efficient. Our decision is discussed in greater detail in sections 4 and 5 of this report.

Our determination is to approve a positive pass through amount of \$6.17 million (\$nominal, smoothed) to be recovered over the three remaining regulatory years of AusNet Services' 2021–26 regulatory control period through the X-factors set in the PTRM, as follows:

- \$2.05 million to be recovered in 2023–24
- \$2.06 million to be recovered in 2024–25
- \$2.06 million to be recovered in 2025–26

We estimate that the approved cost pass through amount will add approximately \$2 to the average residential customer's bills and \$9 to the average small business's bills each year from 1 July 2023 to 30 June 2026.⁶

AusNet Services proposed that the October 2021 storm be deemed a catastrophic event and therefore excluded from the calculation of the Major Event Day (MED) threshold value because it was a clear outlier.⁷ We consider that the effect of the October 2021 storm event has met the MED threshold, thus it has been excluded from the STPIS.

⁶ Our expected bill impact approach shows the incremental dollar impact due to the incremental revenue from the pass through application, while holding all other component costs that make up the electricity bill constant. The Essential Services Commission's Victorian Default Offer 2022–23 is used as the base bill as at 30 June 2023 (Final decision, table 1). Any difference in expected bill impact figures with AusNet Services' proposal is due to our different bill impact approach.

⁷ AusNet Services, *AusNet Services - October 2021 Storm cost pass through - Application* - March 2022. p 22.

1 Introduction

We received a cost pass through application from AusNet Services for additional expenditure related to restoring electricity supply and repairing damage to its network caused by the October 2021 storm in Victoria.

AusNet Services' application proposed to recover \$6.12 million (\$nominal, smoothed) from electricity users through an increase in distribution prices in each of the remaining three years of the current regulatory control period, that is, from 1 July 2023 to 30 June 2026.⁸

This section sets out the AER's role in assessing cost pass through applications from electricity distribution network service providers (DNSP), as well as information on AusNet Services' application.

1.1 Who we are and our role in this 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 distribution and transmission services in the National Electricity Market (NEM). Our electricity-related powers and functions are set out in the National Electricity Law (NEL) and NER.⁹

The AER regulates AusNet Services' revenues through five-year distribution revenue determinations. AusNet Services' current revenue determination for the 2021–26 regulatory control period runs from 1 July 2021 to 30 June 2026.

We are responsible for assessing cost pass through applications.¹⁰ Under the NER, a distribution business may apply to us seeking the recovery of additional costs incurred during a regulatory control period, if predefined events occur as specified in either the NER or in its respective revenue determination.¹¹

1.2 AusNet Services' application

On 10 March 2022, AusNet Services submitted a cost pass through application seeking to recover the costs it has incurred, and is forecast to incur, as a result of the October 2021 storm in Victoria.¹²

⁸ This is equivalent to \$5.7 million (\$2020–21, smoothed) as reflected in AusNet Services' cost pass through application.

⁹ In addition to regulating transmission and distribution in the NEM and the Northern Territory, we also monitor the wholesale electricity market to ensure suppliers comply with the legislation and rules, taking enforcement action where necessary, and regulate retail energy markets in Queensland, New South Wales, South Australia, Tasmania (electricity only) and the ACT.

¹⁰ NER, cl. 6.6.1.

¹¹ NER, cl. 6.6.1(a).

¹² AusNet Services, *AusNet Services – October 2021 Storm cost pass through - Application - March 2022*.

AusNet Services submitted that the October 2021 storm caused extensive damage to its network. The extreme weather, including gusts of wind exceeding 100km/h, resulted in flooding, fallen trees and poles, and significant damage to overhead power lines. At its peak, this resulted in 230,000 customers (approximately 30 per cent of AusNet Services’ customer base) without power.¹³

AusNet Services stated that it has incurred \$9.95 million (\$nominal) in costs as a result of the October 2021 storm, apportioned as shown in table 1 below.¹⁴

Table 1 AusNet Services – costs related to the October 2021 storm (\$million, \$nominal)

	2021-22	2022-23	2023-24	2024-25	2025-26	Total
Capex	5.44	-	-	-	-	5.44
Opex	4.51	-	-	-	-	4.51
Total	9.95	-	-	-	-	9.95

Source: AusNet Services’ October 2021 storm cost pass through application – build up of costs
 Note: '0.0' and '-0.0' represent small nonzero number and '-' represents zero. The numbers in this table are equivalent to the numbers in Table 3 of AusNet Services’ proposal displayed in nominal terms.¹⁵

The revenue impact of the proposed pass through amount is \$6.12 million (\$nominal, smoothed),¹⁶ over the three year period from 1 July 2023 to 30 June 2026.

1.3 Structure of determination

This document sets out our assessment and determination, amongst other things, on whether a cost pass through event has occurred, the pass through amount, the time period for the recovery of the pass through amount, and our reasons for the determination.

The decision is structured as follows.

- Section 2 sets out our determination on AusNet Services’ cost pass through application.
- Section 3 outlines relevant regulatory requirements and our assessment approach.
- Section 4 sets out our reasons for the determination, including our assessment of the proposed positive pass through amount.

¹³ AusNet Services, *AusNet Services - October 2021 Storm cost pass through - Application* - March 2022. p 9.

¹⁴ This is equivalent to \$9.76 million (\$2020–21, smoothed) as reflected in AusNet Services’ cost pass through application.

¹⁵ AusNet Services, *AusNet Services - October 2021 Storm cost pass through - Application* - March 2022. p 16.

¹⁶ This is equivalent to \$5.7 million (\$2020–21, smoothed) as reflected in AusNet Services’ cost pass through application.

- Section 5 sets out our assessment of AusNet Services' cost pass through application against the NER requirements, including whether the materiality threshold is met, and consideration of stakeholder submissions.

2 Determination

Based on our consideration of all the matters set out in this decision, we consider that AusNet Services' application, as submitted on 10 March 2022, establishes that a pass through event has occurred in respect of the October 2021 storm, being a natural disaster pass through event as specified in AusNet Services' 2021–26 revenue determination. Our assessment against the requirements of a positive change event is summarised in section 5 (Table 4).

We are satisfied that the October 2021 storm constitutes a positive change event as defined under the NER. In particular, we are satisfied that AusNet Services incurred a material increase in the costs of providing direct control services in the 2021–22 regulatory year as a result of this pass through event.

Our determination is to approve a positive pass through amount of \$6,166,728 (\$nominal, smoothed), to be recovered over the three remaining regulatory years of AusNet Services' 2021–26 regulatory control period through the X-factors set in the PTRM, as follows:

- \$2,050,676 to be recovered in 2023–24.
- \$2,055,572 to be recovered in 2024–25.
- \$2,060,480 to be recovered in 2025–26.

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

3 Relevant regulatory requirements and assessment approach

The pass through mechanism recognises that an efficient revenue allowance cannot account for certain matters that are uncertain and outside the control of the business and which cannot be prevented or mitigated by prudent operational risk management. A cost pass through enables a network service provider to recover the costs of defined unpredictable, high-cost events not factored into our five-year revenue determination for the business.

Clause 6.6.1(a1) of the NER defines a pass through event as one of the following prescribed pass through events for all distribution network service providers:

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

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 materially higher costs in providing direct control services than it would have incurred but for that event...”¹⁷

We undertake this assessment with reference to the NER and the revenue determination applicable to AusNet Services when the October 2021 storm occurred, which is AusNet Services’ distribution determination for the 2021–26 regulatory control period.¹⁸

As part of this process, we examine whether AusNet Services’ application has addressed matters specified in clause 6.6.1(c) of the NER (see section 5 below (Table 4 and Table 5)). We also determine the materiality of the proposed pass through amount.

Clause 6.6.1(d) of the NER provides that 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.

¹⁷ NER, chapter 10.

¹⁸ See: <https://www.aer.gov.au/node/72919>

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 to the AER a written statement specifying a range of details relating to the event within 90 business days of the relevant 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 AusNet Services' 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.

4 Reasons for determination

The sections below set out the reasons for our determination.

4.1 Occurrence of a natural disaster

This determination relates to a nominated pass through event, being a natural disaster event as specified in AusNet Services' 2021–26 revenue determination.

A natural disaster event is defined in AusNet Services' 2021–26 revenue determination:¹⁹

“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 changes the costs to AusNet Services in providing direct control services, provided the cyclone, fire, flood, earthquake or other event was:

- (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*
- (b) not a consequence of any other act or omission of the service provider.*

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

- (1) whether AusNet Services has insurance against the event;*
- (2) the level of insurance that an efficient and prudent NSP would obtain in respect of the event.”*

4.1.1 Natural disaster event

We consider the October 2021 storm satisfies the definition of a natural disaster pass through event as specified in AusNet Services' determination. In particular, the October 2021 storm was:

- responded to by State and Federal Governments as a natural disaster;²⁰
- unexpected; and
- caused severe damage to property.

For example, the Australian Government made a disaster relief payments to assist Victorians to recover from the damage caused by the storm that occurred on 29 October 2021 (the subject of AusNet Services' application). The Victoria State Emergency Services (VICSES)

¹⁹ AER, *Final decision AusNet distribution determination - Attachment 15 - Pass through events* - April 2021, pp. 17-18

²⁰ Disaster Assist 2021, Australian Government: Department of Home Affairs, <https://www.disasterassist.gov.au/Pages/disasters/current-disasters/Victoria/victoria-storms-commencing-29-october-2021.aspx>, viewed 20 April 2022.

confirmed the severity of the impact the severe weather had on the region containing AusNet Services' network.²¹

Further, a range of other sources including the Bureau of Meteorology and the Insurance Council of Australia also highlighted the severe impact of the storm.²²

The October 2021 storm increased the costs to AusNet Services in providing direct control services and the event was not a consequence of an act or omission of AusNet Services – it was outside of AusNet Services' control, and it was unforeseeable.

4.1.1.1 Effect of the event could not be prevented or mitigated

We consider the decisions and actions of AusNet Services in response to the event were efficient and that the October 2021 storm event could not have been prevented or mitigated through prudent operational risk management.

AusNet Services submitted that it has governance procedures and practices to efficiently manage its exposure to risks it faces as an owner and operator of a distribution network, as well as its approach to storms. In particular, AusNet Services submitted its current emergency response protocol, Strategic Plan for Integrated Response and Contingency System (SPIRACS). SPIRACS outlines criteria for assessing the severity of an event and offers advice on preventative and mitigation controls aimed at reducing the consequences of crisis events. This emergency response protocol formed the response framework by which AusNet Services coordinated and prioritised activities across its network to restore customer supply in response to the October 2021 storm.²³

AusNet Services recently provided the following documents in its June 2021 storms cost pass through, which were also relevant to this event:²⁴

- its asset management plan relating to poles, pole top structures and overhead lines that was effective at the time of both the June and October 2021 storms, as well as any previous versions covering the five years prior to the storms;
- its Vegetation Management Plan that was effective at the time of both the June and October 2021 storms as well as any previous versions covering the five years prior to the storms;
- details of the most recent vegetation clearing carried out prior to both the June and October 2021 storms, including the cost, sections of the network cleared (e.g., name of region/suburb and postcode); and

²¹ Victoria State Emergency Service, News details page - 29 October 2021: VICSES receives thousands of calls for help following storm event, <https://www.disasterassist.gov.au/Pages/disasters/current-disasters/Victoria/Victoria-storms-commencing-29-october-2021.aspx>, viewed 20 April 2022.

²² Australian Government, Bureau of Meteorology: Australia in October 2021, http://www.bom.gov.au/clim_data/IDCKGC1AR0/202110.summary.shtml, viewed 20 April 2022; Insurance Council of Australia, *News release - Insurance Catastrophe extended to include Victoria & Tasmania* – 1 November 2021.

²³ AusNet Services, *AusNet Services - October 2021 Storm cost pass through - Application* - March 2022. p 11.

²⁴ AusNet Services, Response to AER Follow up Questions - assets maintenance and vegetation management - AER information request IR01 to AusNet Services - June 2021 storms cost pass through application, 14 January 2022 (including 14 attachments).

- details of the vegetation management program as well as any bushfire management programs applicable to the area impacted by the storms.

Although AusNet Services has measures in place to deal with inclement weather more generally, severe storms can and do have impacts on the network that cannot readily be mitigated beforehand.

We have reviewed this material and we accept that AusNet Services’ asset management and vegetation management plans were appropriate and that AusNet Services did not reasonably do anything or omit to do anything that had the potential to increase the pass through amount.

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 AusNet Services 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:

“For the purposes of the application of clause 6.6.1, an event results in a DNSP incurring materially higher or materially lower costs if the change in costs (as opposed to the revenue impact) that the DNSP 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 DNSP for that regulatory year.”

As is evidenced in Table 2 below, we consider the additional costs incurred by AusNet Services in providing direct control services as a result of the October 2021 storm meet the materiality threshold for the 2021–22 regulatory year.

Table 2 AER – Materiality assessment of the October 2021 storm event (\$million, nominal)

	2021-22	2022-23	2023-24	2024-25	2025-26	Total
Proposed cost pass through opex	4.51	-	-	-	-	4.51
Proposed cost pass through capex	5.44	-	-	-	-	5.44
Total proposed capex and opex	9.95	-	-	-	-	9.95
AER approved unsmoothed revenues as per 2022-23 RoD updated PTRM	739.52	699.18	680.69	671.67	677.12	3468.18
Materiality	1.3%	0.0%	0.0%	0.0%	0.0%	0.3%

Source: AER’s analysis
 Note: ‘-’ represents zero.

4.3 Timing of AusNet Services' application

Clause 6.6.1(c) of the NER requires a DNSP to submit a pass through application to us within 90 business days of the positive change event occurring.

We consider the October 2021 storm event to have occurred on 29 October 2021. We received AusNet Services' pass through application on 10 March 2022, which was 90 business days after the positive change event occurred.

Following our initial assessment of AusNet Services' application, we issued an information notice to AusNet Services (on 8 April 2022) under clause 6.6.1(e1) of the NER, requesting further information on the scope of works and associated costs.

We received AusNet Services' response to our information notice on 28 April 2022. Accordingly, we are required to make this determination by 23 June 2022.

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,²⁵ including the need to ensure that AusNet Services only recovers any actual or likely increment in costs, to the extent that such an increment is solely as a consequence of the pass through event,²⁶ and that AusNet Services does not recover costs that have or will be factored into AusNet Services' annual revenue requirement.²⁷

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

- the pass through amount reflects only those costs incurred as a result of the October 2021 storm natural disaster event, and not costs incurred as a result of other positive change events, business-as-usual costs, or costs of increasing the scope of network services provided by AusNet Services
- the costs incurred are prudent and efficient costs required to rectify the damage caused by the storm;
- the pass through amount reflects only the incremental cost of the October 2021 storm, taking into account deductions for actual and expected cost savings that will occur as a result of works undertaken to address the storm. For example, the replacement of older assets damaged by the storm with new assets may result in lower future inspection and maintenance costs, which should be deducted from the costs to be passed through.

We are satisfied that AusNet Services' estimates of the increase in capex and opex costs due to the October 2021 storm, accounting for the identified avoided costs, are prudent and efficient. Our reasons for this are discussed below. As such, our determination on the

²⁵ NER, cl. 6.6.1(j).

²⁶ NER, cl. 6.6.1(j)(5).

²⁷ NER, cl. 6.6.1(j)(7).

approved incremental capex and opex costs for the October 2021 storm is the proposed \$9.95 million (\$nominal)²⁸ set out in Table 1 earlier in this determination.

4.4.1 Incremental revenue and pass through amount calculations

We reviewed AusNet Services' proposed cost pass through calculations and identified an error which subtracted the reduction in vegetation management costs twice. We corrected this in our calculations which increased the incremental revenue recovered by the cost pass through from \$6.12 million (nominal, smoothed) to \$6.17 million (nominal, smoothed). This amendment was accepted by AusNet Services in its response to our information request.²⁹

Table 3 details our determination on incremental revenue.

Table 3 AER – approved incremental revenue for the October 2021 storm (\$million, nominal)

	2021-22	2022-23	2023-24	2024-25	2025-26	Total
Return on capital	-	0.26	0.25	0.24	0.22	0.97
Return of capital (regulatory depreciation)	-	0.01	0.01	0.01	0.01	0.04
Operating expenditure	4.51	-	-	-	-	4.51
Net tax allowance	-	-	-	-	-	-
Incremental annual revenue requirement (unsmoothed)	4.51	0.27	0.25	0.25	0.24	5.51
Incremental annual expected revenue (smoothed)	-	-	2.05	2.06	2.06	6.17

Source: AER's analysis

Note: '0.0' and '-0.0' represent small nonzero number and '-' represents zero. The smoothed and unsmoothed revenues are equal in NPV terms. The difference between the nominal smoothed and unsmoothed total revenues is explained by the time value of money.

4.4.2 Costs reflect only October 2021 storm-related costs and not business-as-usual costs

We are satisfied that the costs AusNet Services has incurred are costs incurred as a consequence of the October 2021 storm and do not include business-as-usual costs. This takes into account all the expected savings, in the 2021–26 regulatory period, from works that would have been required in future years and is part of the on-going cost of maintaining the network, but that was brought forward and carried out as a necessary part of the storms restoration activities. These costs have been demonstrated to be incremental costs and separate to the business-as-usual costs of operating the distribution network.

²⁸ This is equivalent to \$9.76 million (\$2020–21, smoothed) as reflected in AusNet Services' cost pass through application.

²⁹ AusNet Services, *Response to AER information request IR01 to AusNet Services - October 2021 storm cost pass through application*, 28 April 2022.

AusNet Services described the process it used for isolating the October 2021 storm-related costs it incurred from its business-as-usual costs as follows:

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

- Fixed fees paid to our contractors that we would have paid if the October 2021 storm did not occur.
- Office-based staff time, as these costs would have been incurred by the business in any event.

We captured expenditures that were in response to the October 2021 storm in a manner consistent with our accounting framework, creating a specific project code in SAP to clearly record and track the costs incurred due to the storms.

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

To ensure confidence in the accuracy of the transactions recorded in our financial system, [...] an independent consultant has reviewed our financial records based on agreed upon procedures.³⁰

We have reviewed AusNet Services' cost calculations and are satisfied AusNet Services' application reflected only the costs incurred as a result of the October 2021 storm.

4.4.3 The level of October 2021 storm-related costs is the prudent and efficient costs to maintain service levels

We are satisfied that the level of costs AusNet Services has incurred as a result of the October 2021 storm reflect efficient costs. We have examined the scope of actions and works AusNet Services undertook in response to the October 2021 storm event.

We note that the unit costs relating to the capex component of the pass through are materially higher than AusNet Services' typical business-as-usual unit costs. However, AusNet Services has sufficiently justified the higher unit cost due to the necessity of the actions and works and their cost.

4.4.4 Cost reflects adjustments for savings to business-as-usual costs resulting from the October 2021 storm expenditure

We are satisfied that AusNet Services' pass through amount reflects deductions for savings to business-as-usual costs resulting from its storm expenditure. AusNet Services proposed an expenditure decrement of \$0.10 million (\$2020–21) in future years to account for future

³⁰ AusNet Services, *AusNet Services - October 2021 Storm cost pass through - Application - March 2022*, p 19.

work that was brought forward to the storms recovery period, and which no longer requires the funding approved in our 2021–2026 distribution determination.³¹

4.4.5 Submissions from stakeholders

We received no submissions from stakeholders.

4.5 Timing of cost pass through recovery

AusNet Services has proposed to recover the incremental revenue arising from its cost pass through application over the remaining three years of its 2021–26 regulatory control period.

We are satisfied that this approach will minimise volatility in AusNet Services' revenue requirements while still allowing it to recover its efficient costs in a timely manner.

³¹ AusNet Services, *AusNet Services - October 2021 Storm cost pass through - Application* - March 2022. p 16.

5 NER requirements and stakeholder submissions

For a cost pass through to be determined, there must be a positive change event that results in an eligible pass through amount. AusNet Services can then submit a pass through application, that must address certain matters specified in the NER.³² We make a determination on AusNet Services’ 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.³³

For the reasons set out in Table 4 below, we are satisfied that a positive change event has occurred, and that AusNet Services’ application relating to the October 2021 storm specifies the necessary matters required by the NER. Additionally, after consideration of the factors set out in Table 5 below, we are satisfied the appropriate pass through amount is \$6.17 million (\$nominal), to be recovered over the three remaining regulatory years of AusNet Services’ 2021–26 regulatory control period.

Table 4: 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? ³⁴	No.
Is the pass through event a contingent project or a trigger event associated with a contingent project? ³⁵	No.
Does the pass through relate to any other event specified in AusNet Services’ 2021–26 distribution determination as a pass through event for that determination? ³⁶	Yes. We consider that the October 2021 storms satisfy the natural disaster pass through event specified in AusNet Services’ determination, which is defined as including cyclone, fire, flood, earthquake or other event, provided the event was not a consequence of the acts or omissions of the service provider. ³⁷
Was the pass through event a consequence of acts or omissions of AusNet Services? ³⁸	No, there is no evidence that AusNet Services’ acts or omissions caused the October 2021 storm. ³⁹
Did the October 2021 storm pass through event entail AusNet Services incurring materially higher costs in providing direct control services than it would have incurred but for the event? ⁴⁰	Yes. As discussed in section 4.2, we consider the additional costs incurred by AusNet Services in providing prescribed distribution services as a result of the October 2021 storm meet the materiality threshold. AusNet Services’ annual revenue requirement (unsmoothed) for the 2021–22 regulatory year during which the storms occurred was \$739.52 million (\$nominal), 1% of which is

³² NER, cl. 6.6.1(c).

³³ NER, cl. 6.6.1 (d).

³⁴ NER, cl. 6.6.1(a1)(1) through 6.6.1(a1)(4); and chapter 10.

³⁵ See the definition of “positive change event” in chapter 10 of the NER.

³⁶ NER, cl. 6.6.1(a1)(5)

³⁷ AER, *Final decision AusNet distribution determination - Attachment 15 - Pass through events* - April 2021, p. 17-18.

³⁸ AER, *Final decision AusNet distribution determination - Attachment 15 - Pass through events* - April 2021, p. 17-18.

³⁹ AusNet Services, *AusNet Services – October Storm 2021 cost pass through - Application* - March 2022. p 8-12.

⁴⁰ That is, does it meet the definition of a “positive change event” as defined in chapter 10 of the Rules.

Requirement of the NER	Our consideration
	\$7.40 million (\$nominal). We consider that the efficient amount of opex and capex incurred as a result of the October 2021 storm (\$9.95 million) exceeds this amount, and therefore the increase in costs incurred in providing direct control services as a result of the event exceed the materiality threshold.
What is the date on which the positive change event occurred?	For the purpose of complying with 6.6.1(c), AusNet Services indicated that the storms occurred on 29 October 2021. We agree with AusNet Services as the Victorian and Federal Governments recognise this date in providing assistance packages to affected individuals and communities. ⁴¹
Did AusNet Services submit a written statement of its pass through application within 90 business days of the positive change event occurring? ⁴²	Yes. As discussed in section 4.3, AusNet Services submitted its written statement on 10 March 2022. We consider that AusNet Services has submitted its written statement within the allowed timeframe.
Did AusNet Services specify details of the positive change event, including the date on which the event occurred, in its written statement? ⁴³	Yes. AusNet Services' written statement is available on our website. ⁴⁴
Did AusNet Services 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 regulatory year? ⁴⁵	Yes. AusNet Services proposed an eligible, positive pass through amount of \$5.7 million (\$2020–21) to be recovered from consumers in the last three years of the current regulatory control period: 2023–24 to 2025–26. ⁴⁶
Did AusNet Services 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? ⁴⁷	Yes. AusNet Services' pass through application (that is, its written statement) set out the costs it incurred as a result of the October 2021 storm, as well as how it calculated its proposed pass through amount. ⁴⁸
Was there a regulatory information instrument applicable to the pass through application? ⁴⁹	No.
Is the pass through amount, in whole or in part, in respect of expenditure for a restricted asset? ⁵⁰	No.

Source: AER's analysis

⁴¹ Disaster Assist 2021, Australian Government: Department of Home Affairs, <https://www.disasterassist.gov.au/Pages/disasters/current-disasters/Victoria/victoria-storms-commencing-29-october-2021.aspx>, viewed 20 April 2022.

⁴² NER, cl. 6.6.1(c).

⁴³ NER, cll. 6.6.1(c)(1) and 6.6.1(c)(2).

⁴⁴ <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/cost-pass-throughs/ausnet-services-%E2%80%93-cost-pass-through-%E2%80%93-october-2021-storm>

⁴⁵ NER, cll. 6.6.1(c)(3), 6.6.1(c)(4), and 6.6.1(c)(5).

⁴⁶ This is equivalent to \$6.12 million (\$nominal, smoothed) as reflected in section 1.2 of this report.

⁴⁷ NER, cl. 6.6.1(c)(6).

⁴⁸ AusNet Services, *AusNet Services - October Storm 2021 cost pass through - Application* – March 2022, section 5.3, pp. 15–16; ASD - Attachment 1 - Build up of costs - Public.

⁴⁹ NER, 6.6.1(c)(7).

⁵⁰ NER, cl. 6.6.1(c1) and (d2).

Table 5: 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 AusNet Services' written statement. ⁵¹	This decision sets out how we have taken into account the matters and proposals set out in AusNet Services' pass through application (written statement).
We must take into account the incremental increase in costs in providing direct control services resulting from the pass through event. ⁵²	In section 4.4 above we set out our assessment of the costs incurred by AusNet Services as a consequence of the October 2021 storm. We have considered the costs that AusNet Services has incurred and is likely to incur as a result of the October 2021 storm as well as the likely cost savings to AusNet Services' business-as-usual activities as a result of its expenditure related to the October 2021 storm.
We must take into account the efficiency of AusNet Services' decisions and actions in relation to the risk of the event. ⁵³	<p>In making this determination, we must take into account the efficiency of AusNet Services' decisions and actions in relation to the risk of the positive change event, including whether AusNet Services has failed to take any action that could reasonably be taken to reduce the magnitude of the eligible pass through amount, or omitted to take any action where such action has increased the magnitude of the amount.</p> <p>We do not have evidence to consider that AusNet Services' decisions and actions in relation to the risk of the positive change events were inefficient. We believe AusNet Services has taken positive actions during the positive change event, including working collaboratively and assisting with authorities where necessary.</p> <p>There does not appear to be any action that AusNet Services has failed to take, that it could reasonably have taken, to reduce the magnitude of the storm repair costs, or that it took or omitted to take which has increased the magnitude of these costs.</p> <p>Therefore, we do not consider that AusNet Services' actions increased the magnitude of the pass through amount.</p>
We must take into account the time cost of money. ⁵⁴	To account for the recovery of the pass through amount over three years commencing from 2023–24, we have used the nominal rate of return, as determined in AusNet Services' 2021–26 distribution determination, as well as a forecast inflation of 2 per cent to calculate the approved pass through amount in nominal terms.
We must take into account the need to ensure that the pass through amount reflects only costs incurred solely as a consequence of the October 2021 storm. ⁵⁵	<p>We have investigated the costs proposed by AusNet Services in its proposal and response to our subsequent information request.</p> <p>We found no evidence to suggest that the costs included in AusNet Services' application were not solely incurred because of the October 2021 storm.</p>
The AER will have regard to whether AusNet Services has insurance against the event, and whether it is the level of insurance that an	AusNet Services submitted that none of the costs in this application related to insured structures. AusNet Services also submitted that it did not have insurance covering poles and wires of its network, and the insurance was limited to

⁵¹ NER, cl. 6.6.1(j)(1).

⁵² NER, cl. 6.6.1(j)(2).

⁵³ NER, cl. 6.6.1(j)(3).

⁵⁴ NER, cl. 6.6.1(j)(4).

⁵⁵ NER, cl. 6.6.1 (j)(5).

Relevant factors under cl. 6.6.1(j)	AER consideration
efficient and prudent network operator would obtain? ⁵⁶	structures such as substations and buildings. AusNet Services stated that not insuring poles and wires is consistent with other network businesses. It explained that obtaining this insurance product is difficult and expensive as few insurers are willing to provide this high risk product. The associated premiums would consequently result in consistently high network charges for customers. ⁵⁷ We note that this approach to managing this risk is generally consistent with comparable peer NEM networks including those also impacted by other natural disasters (e.g., bushfires). As such, we are satisfied that it was prudent and efficient for AusNet Services to not obtain storms insurance cover for its poles and wires assets.
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 ⁵⁸	We do not consider the costs that AusNet Services is proposing to recover have been factored into AusNet Services' annual revenue requirement for the regulatory control period in which the pass through event occurred (e.g. 2021–26).
We must take into account the extent to which AusNet Services' costs have already been funded by previous pass through determinations. ⁵⁹	We scrutinised costs related to this activity in the light of an allowance we provided in the June 2021 storms cost pass through. There is no evidence to suggest that costs included in AusNet Services' application have already been funded by previous pass through determinations.
We must take into account any other factors that we consider relevant. ⁶⁰	The other factors we took into account in our assessment of AusNet Services' application are set out below. The AER must exercise its power in a manner that will or is likely to contribute to the achievement of the National Electricity Objective (NEO).

Source: AER's analysis

⁵⁶ AER, *Final decision AusNet distribution determination - Attachment 15 - Pass through events* – April 2021, p. 18

⁵⁷ AusNet Services, *AusNet Services - October Storm 2021 cost pass through - Application* - March 2022. p 20-21.

⁵⁸ NER, cl. 6.6.1(j)(7).

⁵⁹ NER, cl. 6.6.1(j)(7A).

⁶⁰ NER, cl. 6.6.1(j)(8).

Glossary

Term	Definition
AER	Australian Energy Regulator
Capex	Capital Expenditure
NEL	National Electricity Law
NEM	National Electricity Market
NEO	National Electricity Objective
Opex	Operating Expenditure
