



Attachment 12.02

Pass through events

31 January 2023

PowerWater

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Abbreviations

The following table provides a list of abbreviations and acronyms used throughout this document. Defined terms are identified in this document by capitals.

Term	Definition
AER	Australian Energy Regulator
DNSP	Distribution Network Service Provider
NER	National Electricity Rules
NSP	Network Service Provider
NT	Northern Territory

Overview

Pass through events provide us with an ability to recover sufficient revenue should a nominated event materialise, change our costs of providing distribution services and be outside our control.

We have nominated several specific, pre-defined events that are unpredictable in nature, beyond our control, and if they occur, would involve us incurring significant costs. The pass through mechanism allows us to recover the efficient cost of these events from customers, that we would otherwise not be able to during the regulatory control period. These apply to both standard control services and alternative control services.

We have assessed potential areas of risk or uncertainty for the upcoming 2024-2029 regulatory period that meet the requirements of the Northern Territory (NT) National Electricity Rules (NER) as a pass through event. The majority of these events have previously been accepted by the Australian Energy Regulator (AER) as nominated pass through events for Power and Water including, minor amendments recently proposed by other distribution network service providers (DNSPs) and accepted by the AER.

We have identified two new risks that we consider are not adequately addressed under our current nominated pass through events. These risks relate to cyber attacks and the potential for energy sector reform that may impact Power and Water's structure or accountabilities. We therefore propose to:

- Adopt the renamed and amended Insurance Coverage Event as accepted by the AER in its recent DNSP decisions.
- Adopt the amended Natural Disaster Event as accepted by the AER in its recent DNSP decisions.
- Amend the existing Terrorism Event to include a specific reference to cyber attacks.
- Introduce a new pass through event to cover potential energy sector reform that may impact our structure or accountabilities.

In summary, our proposed events are:

1. **Insurance Coverage Event** to address the risk of costs beyond the limit of a relevant insurance policy due to changes in the insurance market.
2. **Insurer's Credit Risk Event** to address the risk of one of our insurers becoming insolvent and the costs associated with high or lower claims limits or deductibles.
3. **Natural Disaster Event** to address the risk of a natural disaster such as a cyclone, fire, flood or earthquake that increases the cost of providing direct control services.
4. **Terrorism Event** to address the risk of a terrorism event (specifically now including reference to a cyber attack) increasing the cost of providing direct control services.
5. **Energy sector reform** to address potential energy sector reform that may impact our structure or accountabilities increasing costs of providing direct control services.

1. Introduction

The accepted rationale for pass through events is that material changes in costs of providing distribution services, due to events over which the DNSP has no control, undermines the five-year revenue forecast and consequently also regulatory allowances. This in turn would lead to the DNSP having either insufficient or too much revenue relevant to the services which must be provided and the investment required to operate and maintain the network.

The pass through events mechanism fills any gap left after all other avenues to address the risk such as event avoidance, mitigation, commercial insurance and self insurance have been exhausted.

There are a number of core pass through events recognised under the NT NER¹ which apply to all electricity network service providers (**NSP**) (i.e. both distribution and transmission network businesses) as a matter of course. These events each have detailed technical definitions in Chapter 10 of the NT NER, but can broadly be described as follows:

1. **Regulatory Change Event**, being a change to a regulatory obligation or requirement that substantially affects the manner in which the DNSP provides services.
2. **Service Standard Event**, being a change to the nature and scope or the manner in which a DNSP is required to provide direct control services or the, minimum service standards applicable to (direct control) services.
3. **Tax Change Event**, being the imposition or removal of a tax relevant to the DNSP or a change to a relevant tax or the which in which such a tax is applied or interpreted.
4. **Retailer Insolvency Event**, being the failure of an insolvent retailer to pay for services which have been provided to the retailer.

The NT NER also provides for DNSPs to nominate additional events as pass through events in each regulatory proposal for consideration by the AER.² The AER can accept these additional proposed pass through events if they satisfy criteria in the rules known as the “nominated pass through event considerations”.

The AER has consistently recognised a number of events in the past as satisfying these considerations, such that they are generally accepted as a matter of course. These are:

- Insurance Coverage Event.
- Insurers Credit Risk Event.
- Natural Disaster Event.
- Terrorism Event.

However, there is still scope for DNSPs to nominate other events.

The remainder of this document includes:

¹ Clause 6.6.1 of the NT NER

² Clause 6.6.(a1)(5) of the NT NER.

- Section 2 of this document discusses the current nominated pass through events which have applied to the 2019 to 2024 regulatory period.
- Section 3 sets out our proposed approach to nominated pass through events for the 2024-2029 regulatory period.
- Section 4 providing our proposed wording for each of our nominated pass through events.

2. Current nominated pass through events

The current regulatory period included four nominated pass through events. These events align with those proposed by other DNSPs, and accepted by the AER previously. They include events related to insurance, natural disasters, and terrorism.

2.1 Events that apply to our 2019-2024 regulatory period

We proposed and the AER accepted, the following events as additional pass through events for direct control services as part of our 2019-2024 determination:

- **Insurance Cap Event** to address the risk of costs beyond the limit of a relevant insurance policy due to changes in the insurance market.
- **Insurer's Credit Risk Event** to address the risk of one of our insurers becoming insolvent and the costs associated with high or lower claims limits or deductibles.
- **Natural Disaster Event** to address the risk of a natural disaster such as a cyclone, fire, flood or earthquake that increases the cost of providing direct control services.
- **Terrorism Event** to address the risk of a terrorism increasing the cost of providing direct control services.

The AER has previously accepted³ these events as meeting the nominated pass through events considerations set out in the NT NER⁴. These considerations are:

- a. whether the event proposed is an event covered by a category of pass through event specified in clause 6.6.1(a1)(1AA) 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);*
- b. whether the nature or type of event can be clearly identified at the time the determination is made for the service provider;*
- c. 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;*
- d. whether the relevant service provider could insure against the event, having regard to:*
 - (1) the availability (including the extent of availability in terms of liability limits) of insurance against the event on reasonable commercial terms; or*
 - (2) whether the event can be self-insured on the basis that:*
 - (i) it is possible to calculate the self-insurance premium; and*
 - (ii) 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.*
- e. any other matter the AER considers relevant and which the AER has notified Network Service Providers is a nominated pass through event consideration.*

³ Example, AER Final Decision Jemena Distribution Determination - Pass Through Events Attachment 15 April 2021

⁴ Chapter 10 Glossary "Nominated Pass Through Event Considerations".

These considerations align with the rationale underpinning the cost pass through mechanism, that a cost pass through regime must ensure that appropriate incentives are maintained such that a nominated pass through event should only be accepted when it is the least inefficient option such that event avoidance, mitigation, commercial insurance and self-insurance are found to be inappropriate. Put simply, a pass through event is included after ascertaining the most efficient allocation of risks between a service provider and end customers.⁵

2.2 AER's recent approach to nominated pass through events

No further or additional events of general application or relevance to our business have been put forward and or accepted by the AER in its recent determinations for the South Australian and Victorian DNSPs. However, the AER has further developed and improved the Insurance Cap Event, now the Insurance Coverage Event and the Natural Disaster Event. The AER has also made decisions recently that state its view that the definition of a Terrorism Event adequately addresses cyber attacks.

These changes are summarised in the following sections.

2.2.1 Insurance Coverage Event

The key considerations for pass through events in recent decisions has been related to the insurance market, in particular the further development of the Insurance Cap Event into what is now termed the Insurance Coverage Event. These changes have been put forward and accepted by the AER in recognition of the challenges and limitations being experienced in the insurance market.

2.2.2 Terrorism Event

The approach of the AER to date, including in our 2019-2024 determination has been to treat cyber attacks as a form of terrorism within the nominated Terrorism Event definition⁶ but has rejected any need for cyber attacks to be specifically mentioned in the definition.

The definition of "terrorism event" currently adopted by the AER is:

***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:*

- (a) 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*
- (b) increases the costs to Power and Water Corporation in providing direct control services.*

⁵ AER Final Decision Jemena Distribution Determination - Pass Through Events Attachment 15 April 2021 and AEMC, Cost pass through arrangements for Network Service Providers, Rule Determination, 2 August 2012, pp 19 and 20

⁶ AER Draft Decision Power and Water Corporation Distribution Determination 2019 to 2024 Attachment 14 Pass through events at Chapter 14-12 and 13.

2.2.3 Natural Disaster Event

The AER has made minor changes to the definition of Nature Disaster Event included in our 2019-2024 determination to make it clear that the increase in costs must relate to compliance with a regulatory obligation or requirement or with an applicable regulatory instrument.

3. Proposed nominated pass through events

For the next regulatory period, we propose to adopt the AER's definition of Insurance Coverage Event and Natural Disaster Event, We also propose to amend the definition of Terrorism Event to specifically address cyber attacks and introduce a new pass through event relating to the potential for energy sector reform that may impact Power and Water's structure or accountabilities.

Our proposed new event is confidential at this point in time as the nature of the reforms are sensitive, and the Government decision making process is still underway.

3.1 Insurance Coverage Event

We propose to adopt the Insurance Coverage Event as put forward by other DNSPs and accepted by the AER.

Our proposed definition aligns with that approved by the AER in its most recent determinations, and is provided in section 4.1.1.

3.2 Terrorism Event

We propose a change to the definition of the nominated Terrorism Event to more expressly include cyber attacks. We consider that the currently accepted definition of Terrorism Event does not adequately address a major cyber attack. This is because the definition requires the act to be:

..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).

This definition essentially requires the reasons or motivation of the act to be established or at least evident, which may not be possibly or readily apparent. To exemplify this point, at the time this proposal was prepared, two cyber-attacks events had recently occurred in Australia.⁷ It has been publicly reported that these attacks resulted in sensitive and identifying information of large numbers of customers being accessed and or stolen and, in some case, published.

From publicly available information on Optus and Medibank Private websites, there is no indication of the motivation for the attacks. Medicare has expressed the view that the attack is designed to harm customers and cause distress⁸, but the actual motivation is not known and even if this was the motivation it would not necessarily meet element (a) of the definition (i.e. that the motivation was for or in connection political, religious, ideological, ethnic or similar purposes or reasons). It is understood that ransom demands were made in relation to both attacks,⁹ but this does not indicate a motivation of the type required by the definition.

⁷ Optus Cyber Incident September 2022 and Medibank Private Cyber Incident October 2022

⁸ Medibank ASX Release 9 November 2022.

https://yourir.info/resources/229150fa807ea4f2/announcements/mpl.asx/3A606761/MPL_Medibank_cybercrime_update.pdf?embed=1

⁹ SMH 21 October 2022, "The cost of coughing up: Should companies pay the ransom demands of criminals?"

The Australian Government's Australian Cyber Security Centre regards cyber attacks as crimes (cybercrimes) as indicated in its latest report¹⁰, in which it states it received 76,000 cybercrime reports last financial year, up 13% from the previous period. The report describes "cybercrimes" and "cyber security incidents" in the following terms at page 21:

A cybercrime is an offence committed through or against information and communications technology (ICT). Cybercrimes are either cyber enabled (using ICT to facilitate offences such as fraud or sexual exploitation) or cyber dependent (crimes which can only be committed via ICT, such as the use of ransomware or other malware)

A cyber security incident is an event, or series of events, that has a significant probability of compromising an organisation's operations. Not all cybercrimes lead to cyber security incidents

The report goes on to report statistics for both types of events and then separately explains and reports at pages on "cyber espionage" being the malicious actions of state actors involved in political and economic espionage. Importantly the report does not reference "terrorism" as a concept nor does it include cybercrimes as acts of terrorism.

The Medibank and Optus cyber attack cases demonstrate that the financial impacts arising from such incidents can be significant and material. Information available from the Medicare website and released to the ASX (see Chair and CEO AGM Presentation to the Medibank Private Annual General Meeting on 16 November 2022 included in the update to the ASX dated 16 November 2022¹¹) give an indication of the far-reaching impacts of such cyber attacks and in particular the types of costs incurred by these businesses in responding to the attack. For Medibank Private the impact included:

- Estimated pre-tax non-recurring costs of \$25-35 million, impacting earnings in the first half of 2023.
- Applying resources "around the clock" to understand nature and scope and customer data affected.
- Commissioning an external review.
- Deferring premium increases from 1 November 2022 to 16 January 2023.
- Providing specialist identity protection advice and resources for all customers.
- Providing a "Comprehensive Support Package" to customers who have had their data stolen including financial support, identity monitoring services, reimbursement of fees for re-issue of identity documents.
- Providing specialist teams to help customers who receive scam threats.

Power and Water acknowledges that specific recognition of cyber attacks within the pass through framework, does not mean that all cyber attacks would ground a positive (or negative) pass through amount which can be recovered from (or returned) to customers. The success of an application for a positive pass through amount following a cyber attack that increased the costs of providing direct control services would depend on a range of factors set out in the NT NER. in particular clause 6.6.1(j)(3) which requires the AER to take into account the efficiency of the DNSP's decisions and actions in relation to the risk of the event, including whether the DNSP has failed to take any action that could reasonably be taken to reduce the magnitude of the event. Consequently, acceptance of such an event would not dilute or

¹⁰ ACSC, Annual Cyber Threat Report, 2022 <https://www.cyber.gov.au/sites/default/files/2022-11/ACSC-Annual-Cyber-Threat-Report-2022.pdf>

¹¹ https://www.medibank.com.au/content/dam/retail/about-assets/pdfs/investor-centre/annual-general-meeting/2022_AGM_presentations.pdf

remove the responsibility of Power and Water to have in place effective risk management procedures in place.

Our proposed amended definition is provided in section 4.1.3

3.3 Natural Disaster Event

We propose to adopt the Natural Disaster Event as put forward by other DNSPs and accepted by the AER.

Our proposed definition aligns with that approved by the AER in its most recent determinations, and is provided in section 4.1.4.

3.4

[REDACTED]

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¹³ AER Final Decision NSW DNSPs 2009-2014, April 2009 at pages 282-283

4. Proposed nominated pass through events

We propose the five nominated pass through events and definitions for the 2024-29 regulatory period.

We have demonstrated each of these events meet the requirements of nominated pass through events under the NT NER.

4.1 Pass through events for Standard Control Services

4.1.1 Insurance Coverage Event

An insurance coverage event occurs if

1. Power and Water Corporation,
 - 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
 - b. would have been able to make a claim or claims under a relevant insurance policy or set of policies but for changed circumstances; and
2. Power and Water Corporation incurs costs
 - a. beyond a relevant policy limit or set of insurance policies; or
 - b. that are unrecoverable under that policy or set of insurance policies due to changed circumstances; and
3. The costs referred to in paragraph 2 above materially increase the costs to Power and Water Corporation in providing direct control services.

For this Insurance Coverage Event:

“changed circumstances” means movements in the relevant insurance liability market that are beyond the control of Power and Water Corporation, where those movements mean that it is no longer possible for Power and Water Corporation 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.”

“costs” means the costs that would have been recovered under the insurance policy or set of insurance policies had:

- *the limit not been exhausted; or*
- *those costs had not been unrecoverable due to changed circumstances.*

A relevant insurance policy or set of insurance policies is an insurance policy or set of insurance policies held during the 2024-2029 regulatory control period or a previous regulatory control period in which Power and Water Corporation was regulated.

Power and Water Corporation 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 Power and Water Corporation in relation to any aspect of the Network or Power and Water Corporation's network or business.

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:

- the relevant insurance policy or set of insurance policies for the event;
- the level of insurance that an efficient and prudent DNSP would obtain, or would have sought to obtain, in respect of the event;
- any information provided by Power and Water Corporation to the AER about Power and Water's actions and processes; and
- any guidance published by the AER on the matters the AER will likely to have regard to in assessing any insurance coverage event that occurs.

4.1.2 Insurer's Credit Risk Event

An insurer credit risk event occurs if:

An insurer of Power and Water Corporation becomes insolvent, and as a result, in respect of an existing or potential insurance claim for a risk that was insured by the insolvent insurer, Power and Water Corporation:

- 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
- b. incurs additional costs associated with funding an insurance claim, which would otherwise have been covered by the insolvent insurer.

4.1.3 Terrorism Event

A Terrorism or cyber Attack 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:

- a. is a threat of or actual cyber attack; or
- b. 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 which

increases the costs to Power and Water Corporation in providing direct control services.

For this Terrorism or Cyber Attack event a "cyber attack" includes any malicious or unauthorised access, use, interference, destruction or interruption to the information and computer technology systems or assets, including computer networks, internet communications and operational technology system or assets, used by Power and Water Corporation.

4.1.4 Natural Disaster Event

A Natural disaster event means any natural disaster including but not limited to cyclone, fire, flood or earthquake that occurs during the 2024-2029 regulatory control period that changes the costs to Power and Water Corporation 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.*

[REDACTED]

4.2 Pass through events for Alternative Control Services.

Generally, pass through events are developed and operate as part of the control mechanism which applies to Standard Control Services under clause 6.6.1 of the NT NER. The NT NER also recognises that the pass through events mechanism provided for in the NT NER can also apply to alternative control services.¹⁴

We propose the pass through events also be applied as part as the control mechanism for Alternative Control Services. This is particularly important for our metering services, which are based on based on revenue build up approach to derive the prices. This approach is consistent with and promotes the pricing principle set out in section 7(A)(2) of the NT National Electricity Law, which provides that network businesses should be given a reasonable opportunity to be able to recover at least the efficient costs incurred in providing direct control services and complying with regulatory obligations or requirements.

¹⁴ Clause 6.2.6 (b) and (c) of the NT NER

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