

# Attachment 11.1

Proposed Pass Through Mechanism

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# 1 Overview

A cost pass through mechanism provides NTESMO an opportunity to recover sufficient revenue if an event outside of our control occurs and increases the costs of meeting our regulated functions. These costs are unaccounted for in the regulatory determination, including in the allowed revenue and resultant regulated charges.

We have carefully assessed areas of risk or uncertainty for the upcoming 2024-25 to 2026-27 regulatory period. This assessment identified several areas where changes are likely and, if they occur, will materially impact the costs of meeting our obligations.

The forecasts in our proposal are based on Power and Water's current corporate structure and NTESMO's structure within Power and Water. These forecasts reflect the current legislative and regulatory instruments applicable to NTESMO's functions, obligations and activities. The forecasts do not include the potential cost impact of anticipated market reforms and consequential regulatory changes impacting NTESMO's regulatory obligations, functions and activities. This is due to the considerable uncertainty on the scope and timing of these regulatory changes.

To address this uncertainty we are proposing a cost pass through mechanism to provide us with an ability to recover sufficient revenue if certain nominated events occur that materially increase the costs of meeting our regulated obligations, functions and activities.

Our proposed pass through mechanism and nominated events are developed based on the pass through events recognised under the NT NER for our regulated electricity networks. Further, we have considered the specific requirements and uncertainty NTESMO faces over the coming period and the most efficient notification and assessment process for these cost pass through events.

## 2 Nominated Pass Through Events

We propose that the Commission includes four pass through events, these are identified in the following sections.

### 2.1 Regulatory or service standard change event

The regulatory or service standard change event captures any regulatory change that materially impacts our costs by a change in our obligations, functions or activities. The cost pass through would apply to both operating and capital expenditure. While not limited to, we consider the following types of regulatory reform may arise in the next regulatory period that may impact our costs:

- Reform including in the priority areas of dispatch and settlement priority changes, essential system services review, and reliability priority changes including actions to implement this reform.
- A new obligation to perform [REDACTED]

We propose that this be defined as: **A regulatory or service standard change event** and is defined as “a change in a regulatory obligation or requirement that:

*(a) falls within no other category of pass through event*

*(b) occurs during the course of a regulatory period; and*

*(c) affects or changes the manner in which the NTESMO meets its regulatory obligations or requirements”*

For the purposes of this event:

A *regulatory obligation or requirement* is a function or power imposed on NTESMO in its capacity as licensed System Controller under the *Electricity Reform Act NT 2000* (including any regulations, standards or Codes made under that Act) or any other Act.

[REDACTED]

## 2.3 Terrorism or Cyber Attack Event

A terrorism or cyber attack event will apply if a terrorist or cyber security event occurs that increases the costs of NTESMO meeting its obligations.

We propose this event be defined as: **A Terrorism or Cyber Attack event** means an act which occurs during the regulatory period (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) and 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 of NTESMO undertaking its functions and powers as a licensed system controller under the Northern Territory Electricity Reform Act 2000 (including any regulations, standards or Codes made under that Act) or any other Act.

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.

## 2.4 Major System Response Event

A Major System Response Event will apply following a material system event occurring in any regulated region which results in higher costs than forecast in our 2024-25 to 2026-27 regulatory determination.

An example would be the Alice Springs System Black incident which occurred in the current regulatory period on 13 October 2019. Following this incident, the Commission undertook an inquiry into the black system incident and this recommended NTESMO implement several key operational actions e.g., complete review of automatic generation control (AGC) systems and tracking spinning reserve and regulating reserve separately, and included supporting market participants’ participation in the market.

We propose this event be defined as: **A Major System Response Event** is an operational response (including to manage and support the participations of market participants who are participating in the market) which is required by the Northern Territory Government, the Utilities Commission or other regulatory body to be implemented during the regulatory control period by NTESMO in its capacity as a licensed System Controller as a result of a major event on the system which increases the costs of NTESMO in meeting its functions and powers as a licensed system controller under the Northern Territory Electricity Reform Act 2000 (including any regulations, standards or Codes made under that Act) or any other Act.

### 3 Proposed Cost Pass Through Mechanism Process

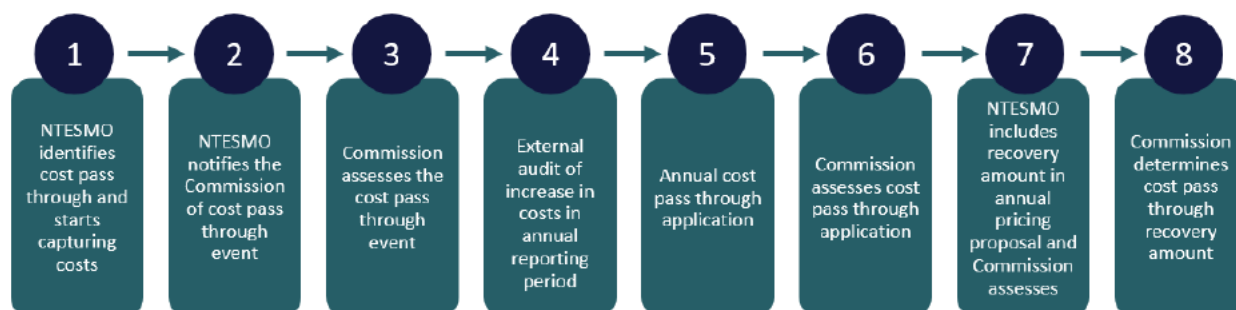
Our proposed process for recovering costs related to pass through events is different from the approach applied by the Australian Energy Regulator (AER) in regulating electricity networks under the NT NER. The rationale for these changes is we needed a more proportionate response. The NT NER requires that network service providers submit a forecast of costs as part of a pass through application for the AER’s approval. The annual amount is then included in subsequent pricing proposals with an adjustment for the time value of money.

In contrast, NTESMO’s proposed process seeks to recover pass through event costs annually on an “as -incurred” basis, and subject to the Commission’s assessing these as efficient costs. A secondary element of our proposed approach is a streamlined method for approving annual cost pass through amounts for multiple events. This approach is preferred as:

- There is likely to be a high level of inaccuracy in forecasting the expected costs related to a pass through event.
- We consider enabling the Commission to undertake a review of actual costs to ensure the efficiency and prudence of NTESMO’s actions provides customers with better safeguards.
- Administration of the pass through mechanism is likely to be simpler and transaction costs lower, as NTESMO and the Commission are not required to undertake onerous (and often inaccurate) assessments of the likely forecast costs for each pass through event.

If any of the nominated pass through events proposed in section 2 occur, we propose that an 8 step process should apply as illustrated in figure 1 and outlined in detail in sections 3.1 to 3.8.

Figure 1: Steps for proposed cost pass through mechanism



Additionally, we propose that a materiality threshold should not be applied for an annual cost pass through application. This is because the impact of these events are likely to be incremental and cumulative in nature and NTESMO will have very limited capacity to reprioritise its expenditure within its allowed revenue to meet these increased costs.

### 3.1 Step 1 – Capture costs when event occurs

Once a pass through event is identified, NTESMO will:

- Commence capturing increases in costs including actual operating and capital costs incurred regarding the event in each year of the 2024-25 to 2026-27 regulatory period.
- NTESMO will establish within its financial system a mechanism to capture all costs associated with the change event.

The cost capture mechanism will be in the form of a separate work order for any costs related to that event. This mechanism would include strict rules to ensure that only incremental costs arising from the cost pass through event are captured. This cost capturing will need to be able to demonstrate that the increase in costs have been incurred solely as a consequence of the change event and were outside the normal fluctuation from forecasts that would normally be expected to occur during a regulatory period.

### 3.2 Step 2 – NTESMO notifies the Commission of an event

Within 60 days of the pass through event occurring, NTESMO must notify the Commission that the event occurred and provide sufficient information to substantiate the change the event has occurred.

### 3.3 Step 3 – Commission’s assessment of event

The Commission must assess NTESMO’s notification and seek further information to enable it to determine whether to accept that a cost pass through event has occurred and will notify its response to the event within 60 days of notification from NTESMO. If approved, this will be termed an “approved pass through event”.

### 3.4 Step 4 – External party audit of increase in costs in annual reporting process

NTESMO’s financial system will identify the operating and capital costs incurred for each approved pass through event for each financial year in the 2025-27 period.<sup>1</sup> NTESMO will arrange for the increase in costs for each approved pass through event to be audited by the end of November in relation to the preceding financial year.<sup>2</sup> This will be done as part of the annual cost reporting proposed in section 11 of the regulatory proposal. This will assist with the verification of the cost increase by providing a comparison of costs prior to and after the cost pass through event.

### 3.5 Step 5 – Annual cost pass through application

In December of each year, NTESMO will make an application to the Commission for the audited increase in costs for the proceeding financial year. The application will set out the ‘proposed recovery amount’ related to the audited costs identified in Step 4 above. The calculation of the amount will include recovery of operating costs and the return on and return of capital, calculated consistently with the method in the regulatory proposal.

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<sup>1</sup> To be clear, this would include expenditure on all pass through events for that year, that is, cumulative expenditure.

<sup>2</sup> For example, an audit conducted by the end of November 2026 would relate to actual costs incurred on pass through events in the 2025-26 financial year.

The application will include the increase in operational and capital expenditure for an approved pass through event for the preceding financial year. The application will include substantiation of the prudence and efficiency of the costs proposed to be passed through. This application would relate to all approved pass through events that have occurred.

### 3.6 Step 6 – Commission assesses pass through application

The Commission must make a decision to approve or substitute the proposed recovery amount in NTESMO's pass through application by 15 February, that is, two months after the submission of the pass through application.

NTESMO will take into account the following criteria when assessing the application (developed from 6.6.2(j) of the NT NER as appropriate):

- a. The efficiency of NTESMO'S decisions and actions in relation to the events and any action that could or should have been taken to reduce the magnitude of the impact.
- b. The time cost of money based on the allowed rate of return for the regulatory control period.
- c. Ensuring that NTESMO only recovers any actual or likely increment in costs to the extent that the increment is solely as a consequence of the pass through event and that those increases could not be reasonably expected to be managed within the forecast expenditures provided for in the NTESMO Revenue Determination.
- d. The proposed costs will not be included in any other previous cost pass through determination.

### 3.7 Step 7 – NTESMO includes recovery amount in annual pricing proposal and Commission assesses

NTESMO will include the proposed pass through recovery amount in the proposed regulated charges as part of its annual pricing proposal to the Commission in March, that is, one month after the Commission's decision on the pass through application. Through this process, a time value of money adjustment will be undertaken consistent with the annual pricing process set out in Attachment 11.2.

### 3.8 Step 8 – Commission determines cost pass through recovery amount

The Commission approves the recovery of the pass through amounts determined at Step 6 as part of the pricing proposal process submitted in Step 7 above.



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# NTESMO