



# **DRAFT DECISION**

## **United Energy Distribution Determination 2021 to 2026**

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

September 2020

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## Note

This attachment forms part of the AER's draft decision on the distribution determination that will apply to United Energy for the 2021–26 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 and demand management innovation allowance mechanism

Attachment 12 – Not applicable to this distributor

Attachment 13 – Classification of services

Attachment 14 – Control mechanisms

Attachment 15 – Pass through events

Attachment 16 – Alternative control services

Attachment 17 – Negotiated services framework and criteria

Attachment 18 – Connection policy

Attachment 19 – Tariff structure statement

Attachment A – Victorian f-factor incentive scheme

# Contents

<b>Note</b> .....	<b>15-2</b>
<b>Contents</b> .....	<b>15-3</b>
<b>15 Pass through events</b> .....	<b>15-4</b>
<b>15.1 Draft decision</b> .....	<b>15-4</b>
<b>15.2 United Energy’s proposal</b> .....	<b>15-5</b>
<b>15.3 Assessment approach</b> .....	<b>15-9</b>
<b>15.4 Interrelationships</b> .....	<b>15-11</b>
<b>15.5 Reasons for draft decision</b> .....	<b>15-12</b>
15.5.1 Insurance coverage, insurer's credit risk, natural disaster, terrorism and retailer insolvency events.....	15-12
15.5.2 Major cyber, act of aggression and electric vehicle uptake.....	15-17
<b>15.6 End of metering derogation event</b> .....	<b>15-22</b>
<b>15.7 Alternative control services</b> .....	<b>15-22</b>
<b>A Jemena proposed insurance coverage event amendments</b> .....	<b>15-27</b>
<b>Shortened forms</b> .....	<b>15-30</b>

## 15 Pass through events

During the regulatory control period United Energy 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. Such events are limited to circumstances where the business can recover potential costs of defined yet unpredictable, high cost events that are outside the control of the business.

The National Electricity Rules (NER) prescribe the following pass through events for all distribution determinations:<sup>1</sup>

- 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.<sup>2</sup> This attachment sets out our draft decision on the nominated pass through events to apply to United Energy's distribution network for the 2021–26 regulatory control period.

### 15.1 Draft decision

Our draft decision is to:<sup>3</sup>

- Accept five of United Energy's proposed nominated pass through events (terrorism, natural disaster, insurance coverage, insurer's credit risk and retailer insolvency event).
- Make minor amendments to the retailer insolvency event definition to incorporate new legislative terms and the natural disaster, insurance coverage and terrorism pass through event definitions to ensure consistency with our recent decisions for other network service providers.<sup>4</sup>
- Not accept United Energy's proposed major cyber, act of aggression and electric vehicle events.

Our reasons are set out in section 15.5 and our cost pass through event definitions in Table 15.2.

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

<sup>2</sup> NER, cl. 6.6.1(a1)(5).

<sup>3</sup> NER, cl. 6.12.1(14).

<sup>4</sup> E.g. AER, *Draft Decision, Essential Energy Distribution Determination 2019–24, Attachment 14 Pass through events*, November 2018, pp. 11–13; AER, *Final Decision, SA Power Networks Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 5-6.

## 15.2 United Energy’s proposal

United Energy’s proposed nominated pass through events are set out in Table 15.1.

**Table 15.1 United Energy’s nominated pass through events**

Pass through event	United Energy proposed definition
Insurance coverage	<p>An insurance coverage event occurs if:</p> <ul style="list-style-type: none"> <li>(a) United Energy makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy or program of insurance policies</li> <li>(b) United Energy incurs costs beyond the policy limit, or which otherwise fall outside the scope of the cover provided, under the relevant insurance policy or policies</li> <li>(c) the costs beyond the policy limit, or otherwise outside the scope of the cover provided, under the relevant insurance policy or policies increase the costs to United Energy in providing direct control services.</li> </ul> <p>For this insurance coverage event:</p> <ul style="list-style-type: none"> <li>(a) a relevant insurance policy is an insurance policy held during the 2021–26 regulatory control period or a previous regulatory control period in which United Energy was regulated</li> <li>(b) the scope of the cover provided by a relevant insurance policy or policies includes the bands of liability for which United Energy is insured. It does not include: <ul style="list-style-type: none"> <li>(1) any liability beyond the policy limit of the policy or policies or</li> <li>(2) any range or band of liability within the policy limit for which United Energy is not insured by the policy or policies</li> </ul> </li> <li>(c) United Energy will be deemed to have made a claim on a relevant insurance policy if the claim is made by a related party of United Energy in relation to any aspect of the Network or United Energy’s business.</li> </ul> <p>Note in assessing an insurance coverage event pass through application the AER will have regard to:</p> <ul style="list-style-type: none"> <li>(a) the insurance policy or policies for the event</li> <li>(b) the level and scope of insurance cover that would be obtained, and the risks that would be insured against, by an efficient and prudent NSP in respect of the event</li> <li>(c) prevailing conditions in the global insurance market at the time the policy or program of policies was obtained.</li> </ul>

Pass through event	United Energy proposed definition
Insurer credit risk	<p>An insurer's credit risk event occurs if an insurer of United Energy 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, United Energy:</p> <ul style="list-style-type: none"> <li>(a) is subject to a higher or lower claim limit or a higher or lower deductible than would have otherwise applied under the insolvent insurer's policy, or</li> <li>(b) incurs additional costs associated with funding an insurance claim, which would otherwise have been covered by the insolvent insurer.</li> </ul> <p>Note: In assessing an insurer's credit risk event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> <li>(a) United Energy's attempts to mitigate and prevent the event from occurring by reviewing and considering the insurer's track record, size, credit rating and reputation</li> <li>(b) in the event that a claim would have been made after the insurance provider became insolvent, whether United Energy had reasonable opportunity to insure the risk with a different provider.</li> </ul>
Natural disaster	<p>Natural disaster event means any natural disaster including but not limited to cyclone, fire, flood or earthquake that occurs during the 2021–26 regulatory control period that increases the costs to United Energy in providing direct control services, provided the cyclone, fire, flood, earthquake or other event was not directly and solely caused by United Energy's negligent or unlawful acts or omissions.</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"> <li>(a) whether United Energy has insurance against the event</li> <li>(b) the level of insurance that an efficient and prudent NSP would obtain in respect of the event</li> <li>(c) whether a relevant government authority has made a declaration that a natural disaster has occurred.</li> </ul>
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, attacks or other disruptive activities against critical infrastructure or underlying technology, or the threat of such attacks or disruptive activities, or the deliberate introduction of malware) of any person or group of persons (whether acting alone or on behalf of or in connection with any</p>

Pass through event	United Energy proposed definition
	<p>organisation or government), which:</p> <p>(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</p> <p>(b) increases the costs to United Energy in providing direct control services.</p> <p>Note: In assessing a terrorism event pass through application, the AER will have regard to, amongst other things:</p> <p>(a) whether United Energy has insurance against the event</p> <p>(b) the level of insurance that an efficient and prudent DNSP would obtain in respect of the event</p> <p>(c) whether a declaration has been made by a relevant government authority that an act of terrorism has occurred..</p>
Retailer insolvency	<p>Until such time as the National Energy Retail Law set out in the Schedule to the National Energy Retail Law (South Australia) Act 2011 of South Australia is applied as a law of Victoria, retailer insolvency event has the meaning set out in the NER as in force from time to time, except that:</p> <p>(a) where used in the definition of 'retailer insolvency event' in the NER, the term 'retailer' means the holder of a licence to sell electricity under the Electricity Industry Act 2000 (Vic)</p> <p>(b) other terms used in the definition of retailer insolvency event in the Rules as a consequence of amendments made to that definition from time to time, which would otherwise take their meaning by reference to provisions of the NER or National Energy Retail Law not in force in Victoria, take their ordinary meaning and natural meaning, or their technical meaning (as the case may be).</p> <p>For the purposes of this definition, the terms 'eligible pass through amount' and 'positive change event' where they appear in the NER are modified in respect of this retailer insolvency event in the same manner as those terms are modified in respect of the retailer insolvency event prescribed in the NER from time to time. Other terms defined in the NER for this purpose (including without limitation 'retailer insolvency costs', 'failed retailer' and 'billed but unpaid charges') which would otherwise take their meaning by reference to provisions of the NER or National Energy Retail Law not in force in Victoria, take their ordinary and natural meaning, or their technical meaning (as the case</p>



Pass through event	United Energy proposed definition
	<p>may be).</p> <p>Note: This retailer insolvency event will cease to apply as a nominated pass through event on commencement of the National Energy Retail Law in Victoria.</p>
Major cyber	<p>Major cyber event' means any significant interruption to the technology systems or assets used by United Energy to provide direct control services occurring during the 2021–26 regulatory control period that materially increases the costs to United Energy in providing direct control services, provided that:</p> <ul style="list-style-type: none"> <li>(a) the interruption was caused by an act of a third party</li> <li>(b) the event does not constitute a 'terrorism event'.</li> </ul> <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"> <li>(a) whether United Energy has insurance against the event</li> <li>(b) the level of insurance that an efficient and prudent DNSP would obtain in respect of the event</li> <li>(c) whether the steps taken by United Energy 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</li> <li>(d) whether the steps taken by United Energy 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.</li> </ul>
Act of aggression	<p>Act of aggression event means:</p> <ul style="list-style-type: none"> <li>(a) an event that constitutes an international armed conflict (within the meaning given to that term by the Geneva Conventions and associated Protocols) involving Australia;</li> <li>(b) an event that constitutes a non-international armed conflict (within the meaning given to that term by the Geneva Conventions and associated Protocols) occurring in Australia; or</li> <li>(c) an act of aggression (within the meaning given to that term by United Nations General Assembly resolution 3314 (XXIX) of 14 December 1974) against Australia,</li> </ul> <p>which occurs during the 2021–26 regulatory control period and materially increases the costs to United Energy in providing direct control services.</p> <p>Note: In assessing an act of aggression event pass through</p>

Pass through event	United Energy proposed definition
	<p>application, the AER will have regard to, amongst other things:</p> <p>(a) whether United Energy has insurance against the event</p> <p>(b) the level of insurance that an efficient and prudent distributor would obtain in respect of the event</p>
Electric vehicle uptake	<p>An electric vehicle event occurs if a government announcement directly related to increased electric vehicle uptake occurs during the 2021–26 regulatory period that materially increases localised electricity demand</p> <p>Note: In assessing an electric vehicle risk event pass through application, the AER will have regard to, amongst other things:</p> <p>(a) United Energy's attempts to mitigate the impact of the event on localised electricity demand</p> <p>(b) whether the event already satisfies a regulatory change event in the Rules</p>

Source: United Energy, *2021–26 Regulatory proposal – Appendix 4 – Uncertainty appendix*, January 2020, pp. 6-28.

## 15.3 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.<sup>5</sup>

Our assessment approach is guided by the National Electricity Objective (NEO) and the Revenue and Pricing Principles (RPPs).<sup>6</sup> 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.<sup>7</sup> The NEO and the RPPs also reflect the importance of incentives to promote economic efficiency,<sup>8</sup> and balance the risks of under and over investment.<sup>9</sup>

In the context of pass through events, we have particular regard to the impact on price, quality, reliability and security of supply that may arise as a result of any change in the efficient operation of, and ability and incentive of, a service provider to invest in its network. This is a similar approach to that taken by the Australian Energy Market Commission (AEMC) when considering pass through event rule changes.<sup>10</sup>

<sup>5</sup> NER, cl. 6.5.10(b), 6.6.1.

<sup>6</sup> NEL, ss. 7 and 7A.

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

<sup>8</sup> NEL, s. 7A(3).

<sup>9</sup> NEL, s. 7A(6).

<sup>10</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 6.

In determining whether we accept a nominated pass through event, we must take into account the 'nominated pass through event considerations' as defined, which are as follows:<sup>11</sup>

- whether the event proposed is an event covered by a category of pass through event specified in clause 6.6.1(a1)(1) to (4) (in the case of a distribution determination) or clause 6A.7.3(a1)(1) to (4) (in the case of a transmission determination);
- whether the nature or type of event can be clearly identified at the time the determination is made for the service provider;
- whether a prudent service provider could reasonably prevent an event of that nature or type from occurring or substantially mitigate the cost impact of such an event;
- whether the relevant service provider could insure against the event, having regard to:
  - the availability (including the extent of availability in terms of liability limits) of insurance against the event on reasonable commercial terms; or
  - whether the event can be self-insured on the basis that:
    - it is possible to calculate the self-insurance premium; and
    - the potential cost to the relevant service provider would not have a significant impact on the service provider's ability to provide network services; and
- any other matter the AER considers relevant and which the AER has notified network service providers is a nominated pass through event consideration.

The AEMC described the purpose of the nominated pass through event considerations as:

to incorporate and reflect the essential components of a cost pass through regime in the NER. It was intended that in order for appropriate incentives to be maintained, any nominated pass through event should only be accepted when event avoidance, mitigation, commercial insurance and self-insurance are unavailable.<sup>12</sup>

that a pass through event should only be accepted when it is the least inefficient option and event avoidance, mitigation, commercial insurance and self-insurance are found to be inappropriate. That is, it is included after ascertaining the most efficient allocation of risks between a service provider and end customers.<sup>13</sup>

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<sup>11</sup> NER, Chapter 10, definition of nominated pass through event considerations.

<sup>12</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 19.

<sup>13</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 20.

This protects the incentive regime under the NER by limiting erosion of a service provider's incentives to use market based mechanisms to mitigate the cost impacts that would arise.<sup>14</sup> This promotes the efficient investment in, and efficient operation and use of, network services for the long term interests of consumers with respect to price.<sup>15</sup>

As a matter of good regulatory practice, we also take into account the desirability of consistency in our approach to assessing nominated pass through events across our electricity determinations and gas access arrangements.<sup>16</sup>

## 15.4 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.<sup>17</sup> 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.<sup>18</sup>

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<sup>14</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 8.

<sup>15</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 8.

<sup>16</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 18.

<sup>17</sup> NEL, s. 16(1)(c).

<sup>18</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, pp. 19–20.

In general, in respect of unforeseen costs that are relatively minor, a service provider should manage them by using up its existing expenditure forecast, or reprioritising or substituting its projects, to avoid seeking cost recovery through the pass through mechanisms.<sup>19</sup> This is reflected in the materiality threshold that applies to cost pass through applications.<sup>20</sup>

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.<sup>21</sup>

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.<sup>22</sup>

## 15.5 Reasons for draft decision

### 15.5.1 Insurance coverage, insurer's credit risk, natural disaster, terrorism and retailer insolvency events

Consistent with our recent determinations for other network service providers,<sup>23</sup> we consider five of United Energy's proposed nominated pass through events (terrorism, natural disaster, insurer's credit risk, insurance coverage and retailer insolvency) meet the nominated pass through event considerations set out in the NER:<sup>24</sup>

- 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 United Energy 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 United Energy and its customers is appropriate and more likely to be in the long-term interests of consumers with respect to price.

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<sup>19</sup> AEMC 2012, *Economic Regulation of Network Service Providers, and Price and Revenue Regulation of Gas Services, Final Position Paper*, 29 November 2012, p. 186.

<sup>20</sup> NER, Chapter 10: Glossary, definition of 'materially'.

<sup>21</sup> 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.

<sup>22</sup> NER, cl. S6.2.1(e)(1)(ii).

<sup>23</sup> AER, *Final Decision, SA Power Networks Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 10–15; AER, *Final Decision, Ergon Energy Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 9–10; AER, *Final Decision, Energex Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 9–10.

<sup>24</sup> 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 nominated pass through events to ensure consistency with recent AER decisions, as set out in Table 15.2.

### 15.5.1.1 Definition of insurance coverage event

We accept the insurance coverage pass through event proposed by United Energy subject to the amendment discussed below. The new definition is consistent with our recent determinations for SA Power Networks, Ergon Energy and Energex.<sup>25</sup>

United Energy (similar to other network operators) often have more than one policy, particularly for bushfire liability insurance. We consider it appropriate to amend this pass through event to reflect the use of multiple insurance policies. Our amended wording is slightly more generic (and therefore more flexible) than that proposed by United Energy, in that we have made reference to a 'set of insurance policies' instead of 'program of insurance policies'. We consider this change reflects insurance market conditions are changing following significant bushfire events in Australia and overseas. The changes are making bushfire coverage more expensive and difficult to procure.

Gaps in a network operator's insurance coverage may occur if United Energy is unable to find suitable insurance providers to fill withdrawn capacity or cannot economically justify higher premiums.

We have refined the pass through definition to allow for unfavourable changes to United Energy's insurance policy, but only under what we have defined as 'changed circumstances'. While United Energy's proposal included a different definition which proposed to cover those costs which fall 'outside the scope of cover', we consider our definition of 'changed circumstances' addresses the same core issues with a more balanced approach. The definition of 'changed circumstances' is as follows:

'changed circumstances' means movements in the relevant insurance liability market that are beyond the control of United Energy, where those movements mean that it is no longer possible for United Energy 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<sup>26</sup> within the scope of that insurance policy or set of insurance policies.

Our decision recognises the possibility of future coverage gaps, negative impact on deductible schedules or reinstatement rights, but also seeks to preserve appropriate pass through event incentives under a normal operating environment.

United Energy proposed that we should, when assessing the pass through event application, have regard to 'prevailing conditions in the global insurance market'. We consider that this is essentially covered when the definition was amended to

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

<sup>26</sup> See Table 15.2 of this Attachment, paragraph 2, under the insurance coverage pass through event definition.

include "changed circumstances". We have also amended the definition to allow us to have regard to any information provided by United Energy about their actions and processes. We believe this will provide us with greater breath of relevant information when considering an insurance coverage event cost pass through application.

As part of the draft decision consultation, Jemena proposed a number of minor amendments to the definition of the insurance coverage pass through event.<sup>27</sup> Jemena's proposed amendments are set out in Appendix A. We did not consider them for the draft decision but will consider them in the final decision for all the Victorian distribution businesses. We welcome United Energy's views on the relevance and merits of those proposed amendments.

As foreshadowed in our recent decisions, we consider it reasonable to provide United Energy and the broader industry with greater clarity and guidance around the matters we are likely to have regard to in assessing any insurance coverage pass through event that occurs. We released a consultation paper<sup>28</sup> on 28 August 2020 seeking stakeholder views on the key elements that will guide our assessment of an insurance coverage pass through event application. This will be used to assist us to develop a draft and final guidance note. We welcome submissions by 30 October 2020.

#### **15.5.1.2 Definition of retailer insolvency event**

We accept the retailer insolvency pass through event but have amended the definition to more efficiently achieve the same effect of ensuring the terms 'retailer insolvency costs', 'failed retailer' and 'billed but unpaid charges' are constantly aligned with how they are defined in the NER.

United Energy's proposed change to achieve that in the definition for retailer insolvency is as follows:<sup>29</sup>

other terms defined in the NER for this purpose (including without limitation 'retailer insolvency costs', 'failed retailer' and 'billed but unpaid charges') which would otherwise take their meaning by reference to provisions of the NER or National Energy Retail Law not in force in Victoria, take their ordinary and natural meaning, or their technical meaning (as the case may be).

United Energy stated that the pass through definition change is in response to the amendment to the NER made in the National Electricity Amendment (Retailer-Distributor Credit Support Requirements) Rule 2017.<sup>30</sup>

We consider the proposed amendment by United Energy to the retailer insolvency event definition is not necessary as the current pass through definition allows for terms prescribed by the NER to be modified from time to time.

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<sup>27</sup> Jemena, *Information request 48*, 22 July 2020, pp. 9–11.

<sup>28</sup> See <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/insurance-coverage-pass-through-event-%E2%80%93-guidance-note>.

<sup>29</sup> United Energy, *2021–26 Regulatory proposal – Appendix 4 – Uncertainty appendix*, January 2020, p. 18.

<sup>30</sup> United Energy, *2021–26 Regulatory proposal – Appendix 4 – Uncertainty appendix*, January 2020, p. 18.



However, to remove any ambiguity, we have amended the pass through definition for retailer insolvency to read as follows:

For the purposes of this definition, the terms 'eligible pass through amount' and 'positive change event' where they appear in the NER **(as well as any subordinate terms including, without limitation, 'retailer insolvency costs', 'failed retailer' and 'billed but unpaid charges')** are modified in respect of this retailer insolvency event in the same manner as those terms are modified in respect of the retailer insolvency event prescribed in the NER from time to time.

We consider that this definition adequately clarifies that the new terms in the NER still apply to the pass through event.

We have applied this definition across all the Victorian distributors for the 2021–26 regulatory control period.

### 15.5.1.3 Definition of terrorism event

United Energy proposed to expand the definition of terrorism beyond 'the use of force and violence' to include:<sup>31</sup>

attacks or other disruptive activities against critical infrastructure or underlying technology, or the threat of such attacks or disruptive activities, or the deliberate introduction of malware.

We have decided to not incorporate this proposed definition and instead leave the definition to be consistent with other network service providers.

We regard the interpretation of 'force and violence' may encompass the risks also characterised as an 'attack and disruptive activity'. However, since the definition is 'not limited to, the use of force or violence' and as such, any attack or disruptive activity would not necessarily be precluded from this pass through event, a change is not needed and the definition should remain consistent with other service providers.

We also consider that the inclusion of malware as an example of terrorism is unwarranted for the same reasons as 'major cyber' event is not be accepted as a pass through event as described below in 15.5.2.

### 15.5.1.4 Definition of natural disaster event

We have made the following amendments to the natural disaster event definition. These are consistent with changes made for other network service providers in our recent decisions.<sup>32</sup>

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<sup>31</sup> United Energy, *2021–26 Regulatory proposal – Appendix 4 – Uncertainty appendix*, January 2020, p. 15.

<sup>32</sup> AER, *Final Decision, SA Power Networks Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 11–13; AER, *Final Decision, Ergon Energy Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 9–10; AER, *Final Decision, Energex Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 9–10.



In our definition of 'natural disaster' event we have included additional factors, which we will have regard to when assessing whether a natural disaster event occurred as a consequence as an act or omission of United Energy.

This change was a result of other network service providers raising issues in previous revenue determinations where compliance with regulations could prevent those network service providers from meeting pass through requirements.<sup>33</sup> We do not consider adding the word 'unlawful' as the appropriate solution, as it would broaden the scope of the pass through event considerably.

The definition now states that:

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 increases the costs to United Energy in providing direct control services, provided the fire, flood 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.

We have removed the additional reference to 'cyclone' and 'earthquake' in the 'in providing direct control services, provided the cyclone, fire, flood, earthquake or other event'. We believe that this decision will have no effect on United Energy as 'cyclone' and 'earthquake' would be included on the 'other event' classification.

We have also removed the need for declarations by a relevant government authority that a natural disaster event has occurred (called the Declaration Consideration in this Attachment) from the specified list of matters that the AER will consider in assessing a natural disaster pass through event. This is consistent with recent decisions for TasNetworks,<sup>34</sup> Evoenergy (electricity distribution)<sup>35</sup> and SA Power Networks.<sup>36</sup> Removing this reference will not prevent the AER from having regard to whether a declaration has been made.

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<sup>33</sup> SA Power Networks, *2020–25 Revised Regulatory Proposal, Attachment 13, Pass through events*, December 2019, p. 19.

<sup>34</sup> AER, *Final decision, TasNetworks Transmission and Distribution Determination 2019–24, Overview*, April 2019, p. 60.

<sup>35</sup> AER, *Final decision, Evoenergy Distribution Determination 2019–24, Overview*, April 2019, p. 47.

<sup>36</sup> AER, *Final Decision, SA Power Networks Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 10–13.

## 15.5.2 Major cyber, act of aggression and electric vehicle uptake

### 15.5.2.1 Major cyber event

Our draft decision is to not accept United Energy's 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 SA Power Networks' 2020–25 regulatory determination.<sup>37</sup>

Our draft decision does not mean United Energy 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.<sup>38</sup>

United Energy proposed to include a 'major cyber' event and defines it as:<sup>39</sup>

Any significant interruption to the technology systems or assets used by United Energy to provide direct control services occurring during the 2021–26 regulatory control period that materially increases the costs to United Energy 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' type of event can be conceptually covered by a category of pass through event, the nature and type of this event must be clearly identified. The above definition by United Energy is vague and its specificity is by exclusion of a "terrorist event". We are not satisfied that United Energy has met the NER's considerations for a pass through event.

While referencing its current insurance policy precluding events of this type,<sup>40</sup> we are not persuaded that United Energy has provided sufficient evidence that commercial insurance is totally unavailable if United Energy clearly defines the scope. More importantly, in the process of managing these new risks, it is important a service provider retain the incentives to invest efficiently in its system to guard against cyber-security threats, as well as to explore all available market-based mechanisms such as insurance and risk mitigation strategies before we accept it as a nominated cost pass through event.

Further, United Energy stated in its proposal that it cannot prevent a major cyber event from occurring and cannot substantially mitigate the cost impacts of this type of

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<sup>37</sup> AER, *Draft Decision, SA Power Networks Distribution Determination 2020–25, Attachment 14 Pass through events*, October 2019, pp. 14–16.

<sup>38</sup> AER, *Final decision, United Energy Distribution Determination 2016–20, Attachment 15 Pass through events*, May 2016, p. 18; AER, *Draft decision, Essential Energy Distribution Determination 2019–24, Attachment 14 Pass through events*, November 2018, pp.13–14.

<sup>39</sup> United Energy, *2021–26 Regulatory proposal – Appendix 4 – Uncertainty appendix*, January 2020, p. 20.

<sup>40</sup> United Energy, *2021–26 Regulatory proposal – Appendix 4 – Uncertainty appendix*, January 2020, p. 21.

event.<sup>41</sup> United Energy operates national critical infrastructure and is subject to stringent cyber security compliance requirements. We consider it unrealistic that United Energy would have no appropriate safeguards or contingency plans to substantially mitigate the risks and cost impacts of major cyber-attacks.

Supporting this, our draft decision substitute estimate of total capital expenditure includes the cyber security information and communications technology (ICT) capital expenditure that United Energy proposed.<sup>42</sup> This expenditure is intended for United Energy to strengthen its capability to proactively identify, protect, detect, respond to and recover from cyber security threats.

Cyber security risk is one of the key business risks an energy network service provider faces and we consider this business risk should be largely borne by the network service provider, who is best placed to manage it, rather than consumers. We consider accepting broadly defined proposed 'major cyber' event is likely to have the effect of passing United Energy's 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 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 we were to accept this pass through event, the incentive on United Energy and other service providers to proactively manage cyber security risks and adopt best practices would likely be significantly reduced.

Although United Energy has no control on what third parties do, it controls the cyber security and protection of its ICT systems and assets, which affects its susceptibility to cyber-attacks and the likelihood of a 'major cyber' event. United Energy 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 United Energy 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.

United Energy also stated it has addressed the considerations above by including in the definition of its proposed 'major cyber' event the following assessment factors:<sup>43</sup>

whether the steps taken by United Energy 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

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<sup>41</sup> United Energy, *2021–26 Regulatory proposal – Appendix 4 – Uncertainty appendix*, January 2020, p. 21.

<sup>42</sup> AER, *Draft decision, United Energy Distribution Determination 2021–26, Attachment 5 Capital expenditure*, September 2020, Appendix A.5.

<sup>43</sup> United Energy, *2021–26 Regulatory proposal – Appendix 4 – Uncertainty appendix*, January 2020, p. 20.

whether the steps taken by United Energy 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.

While it is necessary to include these considerations in any major cyber event, we consider that a service provider would be incentivised to undertake these steps prior to the event occurring.

Overall, we are not satisfied that United Energy has sufficiently identified the nature or type of event nor exhausted the extent to insure its exposures when clearly scoped on reasonable commercial terms. Accordingly, we do not accept the "major cyber" pass through event nominated by United Energy in its proposal.

### 15.5.2.2 Act of aggression

We do not accept United Energy's act of aggression event because we are not satisfied that the proposed event meets the nominated pass through considerations under the NER.

United Energy proposed an 'act of aggression' event to address potential substantial costs increases resulting from a broad range of events, including 'international armed conflict', 'non-international armed conflict', ' and 'act of aggression'.<sup>44</sup>

United Energy considered its proposal is materially different to a similarly-named pass through event that we did not accept in our 2019–24 determination for Essential Energy. United Energy claimed that it has addressed its shortcomings, namely:

- Unlike Essential Energy, by defining the event with reference to international law, United Energy is of the view that the event is now of a nature or type that can be clearly identified.
- By showing that such risks are a standard exclusion from commercial insurance policies, United Energy contested our previous decision that implied that a prudent service provider could substantially mitigate the cost impact of such an event through insurance.
- United Energy also submitted that the risks associated with the proposed 'act of aggression' event are no less able to be mitigated than a natural disaster or terrorism event.
- United Energy did not accept that such acts of aggression that have the potential to directly impact a distributor's physical assets are limited to physical invasions of Australia.

We discuss these issues below.

In our 2019–24 determination for Essential Energy, we determined that the 'war event' did not satisfy the NER requirement that a cost pass through event be clearly identified

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<sup>44</sup> United Energy, *2021–26 Regulatory proposal – Appendix 4 – Uncertainty appendix*, January 2020, p. 22.

at the time the determination is made. We considered the proposed event was extremely broad and it was not clear what kind of costs it was intended to cover, or what the driver of the change in costs would be.<sup>45</sup> Based on this uncertainty, we also concluded that Essential Energy did not show that a prudent service provider could not substantially mitigate the cost impact of such a war event, or could not insure (or self-insure) against the event.<sup>46</sup>

We consider that compared to Essential Energy, United Energy's proposed definition of an 'act of aggression' event poses similar difficulties regarding breadth and uncertainty. For example, United Energy relied on the concepts of 'international armed conflict', 'non-international armed conflict' and 'act of aggression' which, although they may be terms which incorporate a legal meaning, this does not necessarily make them any less broad in scope or any less open to interpretation. We consider that there are similar uncertainties with United Energy's definition regarding what kind of costs the proposed event is intended to cover, or what the drivers of the change in costs would be. Consequently, we are not satisfied that United Energy has clearly identified the proposed event at the time the determination is made.<sup>47</sup>

In explaining the reason for seeking this pass through event, United Energy stated in its proposal - "While we have in place systems to mitigate the risk associated with an act of aggression event occurring, we cannot as a prudent and efficient service provider completely eliminate the risk of such an event occurring".<sup>48</sup> We consider that there is a misplaced emphasis in United Energy's reason to seek a nominated pass through event. As pass through events are limited to unpredictable, infrequent and high cost events that are beyond the control of a service provider, we are careful to ensure that the businesses have done all they could to try to manage and mitigate risks (including seeking to insure or self-insure) associated with such an event occurring. At the same time we are not aware of anything in the National Electricity Law or NER that requires a service provider to completely eliminate a risk or that it is prudent or efficient to do so in all circumstances.

Hence, while there are risks that are not possible to insure against or self-insure, the pass through provisions are not there to protect service providers under all conceivable circumstances that adversely impact on the service provider. We acknowledge, as submitted by United Energy, that there are limited (if any) insurance products to cover against 'act of aggression' (e.g. war-related risks) and it may be the case that these risks are practically uninsurable. Even if it is true, it does not follow that such a pass through event should readily be available to a regulated business. Most importantly, we consider United Energy has defined the proposed event too broadly, as discussed above, and failed to clearly identify the nature and type of event for its purpose.

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<sup>45</sup> AER, *Draft decision, Essential Energy 2019–24, Attachment 14 Pass through events*, January 2019, p. 13.

<sup>46</sup> AER, *Draft decision, Essential Energy 2019–24, Attachment 14 Pass through events*, January 2019, pp. 13-14.

<sup>47</sup> NER, cl. 6.6.1(a1)(2).

<sup>48</sup> United Energy, *2021–26 Regulatory proposal – Appendix 4 – Uncertainty appendix*, January 2020, January 2020, p. 22.

Accordingly, we do not accept the act of aggression pass through event nominated by United Energy in its proposal.

### 15.5.2.3 Electric vehicle uptake

We do not accept United Energy's proposed electric vehicle (EV) uptake event because we are not satisfied it meets the nominated pass through considerations under the National Electricity Rule.

United Energy has nominated an EV uptake pass through event to manage the uncertainty regarding the cost impacts and timing of an accelerated uptake of EV.<sup>49</sup> It claimed that "where there is a change in policy announcement but there is no subsequent passage of law or regulations or other regulatory instrument there is a risk the costs of such an event would not be covered by existing arrangements".<sup>50</sup> It further stated that the NER does not cover introduction or announcement of new policies.<sup>51</sup>

Stakeholder submissions did not agree with United Energy's view of the risks and uncertainty it faces on its network by the likely impact of EVs. For example, the Victorian Community Organisations considered that the distributors will have more than adequate time to respond to any increase in demand caused by the EV uptake as "any introduction of policies leading to an increase in EVs is not going to cause an instantaneous increase in demand and it is likely to occur over a considerable period of time".<sup>52</sup> Energy Consumer Australia's (ECA) submission saw this as an opportunity for a service provider to design EV tariffs that encourage charging at times that will mitigate the impact on demand growth.<sup>53</sup> ECA viewed that both the level of capital investment and emphasis on digitalisation of the network by the Victorian networks in their current proposal allow for the scope to mitigate any higher than expected EV uptake.<sup>54</sup> Relevantly, ECA's submission pointed out that a pass through mechanism for EV could act as a disincentive to progress tariff strategy.<sup>55</sup>

United Energy also noted in its proposal that the 2019 Senate Inquiry recommended the Australian Government encourage EVs including developing standards and regulations for charging infrastructure and electricity grid integration.<sup>56</sup> We have no reasons to doubt why such a major policy initiative could not be developed and managed as foreshadowed. United Energy did not cite any similar past incidents or substantiated with examples of future events where it is conceivable that networks could incur material cost impacts to their disadvantage as a result of potential policy introductions or announcements.

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<sup>49</sup> United Energy, *2021–26 Regulatory proposal – Appendix 4 – Uncertainty appendix*, January 2020, p. 27.

<sup>50</sup> United Energy, *2021–26 Regulatory proposal – Appendix 4 – Uncertainty appendix*, January 2020, p. 27.

<sup>51</sup> United Energy, *2021–26 Regulatory proposal – Appendix 4 – Uncertainty appendix*, January 2020, p. 27.

<sup>52</sup> Victorian Community Organisations, *EDPR 2021–26 Submission to Initial Proposals*, 29 May 2020, p. 76.

<sup>53</sup> Energy Consumers Australia, *Victorian Electricity Distributors Regulatory Proposals 2021–26, Attachment 1: A review of Victorian Distribution Networks*, p. 36.

<sup>54</sup> Energy Consumers Australia, *Victorian Electricity Distributors Regulatory Proposals 2021–26, Attachment 1: A review of Victorian Distribution Networks*, p. 36.

<sup>55</sup> Energy Consumers Australia, *Victorian Electricity Distributors Regulatory Proposals 2021–26, Attachment 1: A review of Victorian Distribution Networks*, p. 36.

<sup>56</sup> The Senate, *Select Committee on Electric Vehicles Report*, January 2019, p. xi.



We are therefore not persuaded that United Energy has demonstrated sufficiently that:

- the risks that it outlines related to EV policy introduction are likely to occur, and/or
- the range of any such cost impacts is likely to be material,

to satisfy the considerations for a nominated pass through event under the NER.

## 15.6 End of metering derogation event

In its proposal, United Energy sought clarification on whether an ‘end of metering derogation’ event would be a regulatory change or service standard event, consistent with the last regulatory control period 2016–2020 determination.<sup>57</sup> However, United Energy did not make a specific proposal in this regard. Accordingly, we have not made a determination on this matter.

## 15.7 Alternative control services

United Energy proposed that we:<sup>58</sup>

- Confirm our 2016–20 determination that the cost impacts of defined and nominated pass through events on the provision of alternative control services may be recovered under the pass through provisions.
- Modify the materiality threshold for pass through events that result in increased costs for alternative control services to one per cent of the revenue of impacted alternative control services.

We consider the above elements of United Energy's proposal were considered and dealt with in our final framework and approach (F&A) paper.<sup>59</sup> The full discussion of our draft decision on this matter is set out in Attachment 14 Control mechanisms (section 14.5.3).

Our position on a modified materiality threshold for alternative control services remains unchanged from that stated in our F&A paper.<sup>60</sup> However, we consider that a pass through event may occur that impacts both standard control services and alternative control services. Where this occurs, we consider that a business may be able to propose a pass through with elements that will be passed through in standard control services, and other elements passed through in alternative control services where appropriate. Where the administrative burden of applying an amount of the pass through to alternative control services exceeds the benefit of segregating the amounts, we consider the total pass through amount can be allocated to be passed through to standard control services. This can be provided for within a cost pass through

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<sup>57</sup> United Energy, *2021–26 Regulatory proposal – Appendix 4 – Uncertainty appendix*, January 2020, p. 28.

<sup>58</sup> United Energy, *2021–26 Regulatory proposal – Appendix 4 – Uncertainty appendix*, January 2020, p. 29.

<sup>59</sup> AER, *Final framework and approach AusNet Services, CitiPower, Jemena, Powercor and United Energy*, January 2019, p. 58.

<sup>60</sup> The F&A incorrectly referred to 1 per cent of standard control service revenue, however the NER states that the materiality threshold is 1 per cent of direct control services revenues, being the aggregate of all standard and alternative control services revenue. We do not believe that this error in the F&A overrides the NER.

proposal. Table 15.2 summarises the nominated pass through events accepted by us in the draft decision.

**Table 15.2 AER pass through event definitions**

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



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

Pass through event	Approved definition
	<p>(a) a consequence of an act or omission that was necessary for the service provider to comply with a regulatory obligation or requirement or with an applicable regulatory instrument; or</p> <p>(b) not a consequence of any other act or omission of the service provider.</p> <p>Note: In assessing a natural disaster event pass through application, the AER will have regard to, amongst other things:</p> <p>(1) whether United Energy has insurance against the event,</p> <p>(2) the level of insurance that an efficient and prudent NSP would obtain in respect of the event.</p>
Terrorism	<p>Terrorism event means an act (including, but not limited to, the use of force or violence or the threat of force or violence) of any person or group of persons (whether acting alone or on behalf of or in connection with any organisation or government), which:</p> <p>(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</p> <p>(b) increases the costs to United Energy in providing direct control services.</p> <p>Note: In assessing a terrorism event pass through application, the AER will have regard to, amongst other things:</p> <p>i. whether United Energy has insurance against the event;</p> <p>ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event; and</p> <p>iii. whether a declaration has been made by a relevant government authority that a terrorism event has occurred.</p>
Retailer insolvency	<p>Until such time as the National Energy Retail Law set out in the Schedule to the National Energy Retail Law (South Australia) Act 2011 of South Australia is applied as a law of Victoria, retailer insolvency event has the meaning set out in the NER as in force from time to time, except that:</p> <p>(a) where used in the definition of 'retailer insolvency event' in the NER, the term 'retailer' means the holder of a licence to sell electricity under the Electricity Industry Act 2000 (Vic); and</p>

Pass through event	Approved definition
	<p>(b) other terms used in the definition of retailer insolvency event in the Rules as a consequence of amendments made to that definition from time to time, which would otherwise take their meaning by reference to provisions of the NER or National Energy Retail Law not in force in Victoria, take their ordinary meaning and natural meaning, or their technical meaning (as the case may be).</p> <p>For the purposes of this definition, the terms 'eligible pass through amount' and 'positive change event' where they appear in the NER (as well as any subordinate terms including, without limitation, 'retailer insolvency costs', 'failed retailer' and 'billed but unpaid charges') are modified in respect of this retailer insolvency event in the same manner as those terms are modified in respect of the retailer insolvency event prescribed in the NER from time to time.</p> <p>Note: This retailer insolvency event will cease to apply as a nominated pass through event on commencement of the National Energy Retail Law in Victoria.</p>

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Source: AER analysis

# A Jemena proposed insurance coverage event amendments

## 3. AER Question 3

In light of the recent SA Power Network's final decision on the insurance coverage event pass through definition, can Jemena confirm if this addresses their concerns in relation potential gaps in liability coverage?

### 3.1 Jemena Response – Question 3

As identified in the SAPN final decision, the industry is experiencing new challenges with insurance in that there is a growing risk because of gaps in the coverage below the insurance cap. The insurance cap event—which applied in previous regulatory control periods—would not represent an adequate means of managing this risk, as this mechanism was predicated on there being no gaps in the insurance layers or coverage within a layer. As this is no longer the case, a transition to a coverage event represents an improvement to the management of this risk over the previous 'cap' event.

For the most part, we consider the approach adopted in the SAPN final decision is a workable model to address the new challenges presented to distribution business through changes in the insurance market (although we have some residual concerns that we hope will be addressed in the AER's consultation paper as noted in the SAPN final decision<sup>33</sup>). Further, we consider that with a few minor drafting changes the SAPN insurance coverage event could be applied to JEN. These amendments are intended to clarify the circumstances in which this event is triggered or where insurance that is in place either:

- a) becomes unavailable,
- b) remains available, but the terms change so that they are not reasonable commercial terms (and therefore it is not appropriate to maintain that insurance coverage), or
- c) becomes only partly available, so that where insurance comprises various layers of coverage, one of those layers is not available, or where there is a gap within a layer – and an event occurs which results in JEN bearing costs that it would not otherwise have borne;

Using the SAPN insurance coverage event as a baseline, we have marked-up the recommended changes in the text below.<sup>34</sup> Within the text, we have also included some drafting notes highlighted in grey shading to outline our reasoning for the proposed changes.

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An insurance coverage event occurs if:

1. JEN:
  - 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 insurance policies but for changed circumstances; and
2. JEN incurs costs:
  - a) beyond a ~~relevant~~ policy limit for ~~that the relevant insurance~~ policy or set of insurance policies; or

<sup>33</sup> AER, *FINAL DECISION SA Power Networks Distribution Determination 2020 to 2025, Attachment 14 Pass through events*, June 2020, Pg. 14-14.

<sup>34</sup> We note that the changes from SAPN to JEN are not marked-up given then obvious reason for the change.

*[JEN Note: minor changes have been made to reflect defined terms – otherwise scope and intent unaltered.]*

- b) that are unrecoverable under ~~that~~ the relevant insurance policy or set of insurance policies (whether wholly or in part) due to changed circumstances; and

*[JEN Note: we think “unrecoverable” on its own could be interpreted as limiting (b) to the circumstance where insurance is not available at all. Since we are also trying to capture the circumstance where one layer is unavailable, or there is a gap within a layer, we have included some additional wording to make the intent clearer.]*

3. The costs referred to in paragraph 2 above materially increase the costs to JEN in providing direct control services.

For the purposes of this insurance coverage event:

- ‘changed circumstances’ means movements in the relevant insurance liability market that are beyond the reasonable control of JEN, where those movements result in ~~mean that it is~~ no longer being possible for JEN to take out with a reputable insurer:
  - i. ~~an~~ relevant insurance policy or,
  - ii. in the case of a set of insurance policies, one or more layers of insurance within that set (or there are otherwise one or more gaps within the set),
 either 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.~~

*[JEN Note: we have revised wording in the above definition to better deal with the unavailability of insurance layers within the set, and also to clarify it has to be insurance offered by a reputable insurer (see definition below). We have also deleted the last two lines of this definition which refer to costs, because it is unnecessary to include the wording here in this definition when it is already covered off in para 2 and below in separate definition.]*

- ‘costs’ means the ~~costs amount~~ that would have been recoverable ~~ed~~ under the relevant insurance policy or set of insurance policies had:
  - i. the limit not been exhausted; or
  - ii. those costs not been unrecoverable due to changed circumstances.

*[JEN Note: it is appropriate that this definition refer to amounts that are “recoverable” rather than “recovered”, consistent with the wording in para 2 above.]*

- ‘reputable insurer’ means an insurer with a current financial security rating of “A-” or better by Standard and Poor’s (or the equivalent rating with another reputable rating agency).

*[JEN Note: our understanding is that this is well-accepted as a means of determining whether an insurer is reputable – i.e. an entity to which a prudent DNSP would look to provide insurance coverage.]*

- A relevant insurance policy or set of insurance policies is an insurance policy or set of insurance policies held during the regulatory control period or a previous regulatory control period in which JEN was regulated.
- JEN will be deemed to have made a claim on a relevant insurance policy or set of insurance policies if the claim is made by a related party of JEN in relation to any aspect of JEN’s network or business.
- JEN 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 JEN in relation to any aspect of JEN’s network or business.

Note for the avoidance of doubt, in assessing an insurance coverage event through application under rule 6.6.1(i), 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; and
- Any information provided by JEN to the AER about JEN's actions and processes.

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Source: Jemena, *Information request 48*, 22 July 2020, pp. 9–11.

## Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
capex	capital expenditure
CCP 17	Consumer Challenge Panel, sub-panel 17
distributor / DNSP	distribution network service provider
ECA	Energy Consumers Australia
EV	electric vehicle
ICT	information and communications technology
NEL	National Electricity Law
NEO	National Electricity Objective
NER	National Electricity Rules
NSP	network service provider
opex	operating expenditure
RPP	revenue and pricing principles