

# **Jemena Electricity Networks (Vic) Ltd**

**2016-20 Electricity Distribution Price Review  
Regulatory Proposal**

**Revocation and substitution submission**

Attachment 4-1 Risk management framework

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## ABBREVIATIONS

AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
AMI	Advance Metering Infrastructure
DNSP	Distribution Network Service Provider
JEN	Jemena Electricity Networks (Vic) Ltd
NECF	National Energy Customer Framework
NEL	National Electricity Law
NEO	National Electricity Objective
NER	National Electricity Rules
Optimal NEO Position	the position which contributes to the achievement of the NEO to the greatest degree and best promotes the long term interests of consumers of electricity








## OVERVIEW

**Key messages**


- Jemena Electricity Networks (Vic) Ltd (**JEN**) accepts the majority of the views of the preliminary decision in relation to JEN's April 2015 proposal for nominated pass through events.
- However, JEN considers that the definitions for insurer credit risk event, natural disaster event and terrorism event in our April 2015 proposal should be utilised because (in contrast to the proposed definitions in the preliminary decision) they better promote the **Optimal NEO Position**.<sup>1</sup>
- JEN's proposed definitions:
  - are clear, certain and transparent
  - effectively capture, and appropriately balance, the consequences of the risk events
  - ensure the focus is on the appropriate NEO considerations (in particular the cost impact of the event rather than the magnitude of the event)
  - are consistent with the nominated pass through considerations in the NER.

1. The April 2015 proposal (together with any supporting material contained or referred to in the April 2015 proposal) is incorporated into, and forms part of this submission.

**Table OV–1: Overview of our response to preliminary decision on the cost pass through**

Proposed cost pass through events (April 2015)	Preliminary decision	Our response to PD	Our submission (January 2016)
Insurance cap event	Approve with modification		Accept the preliminary decision definition
Insurer credit risk event	Approve with modification		Same as April 2015 proposal
Natural disaster event	Approve with modification		Same as April 2015 proposal
Terrorism event	Approve with modification		Same as April 2015 proposal
Retailer insolvency event	Approve with modification		Accept the preliminary decision approach to link the definition to refer to the rule in force at the time
End of metering derogation event	Do not approve		Accept that this event would be covered under the regulatory change event
Carbon cost event	Do not approve		Accept that this event would be covered under the regulatory change event

<sup>1</sup> The position which contributes to the achievement of the National Electricity Objective (**NEO**) to the greatest degree and best promotes the long term interests of consumers of electricity

Proposed cost pass through events (April 2015)	Preliminary decision	Our response to PD	Our submission (January 2016)
Application of pass throughs to alternative control services	Approve		Accept the preliminary decision

## PASS THROUGH PROVISIONS AND THE NEO

2. The National Electricity Rules (**NER**) allow Distribution Network Service Providers (**DNSPs**) to propose nominated pass through events under clause 6.6.1(a1)(5) of the NER. If such an event occurs, the affected DNSP can recover costs associated with the event via its tariffs during the affected regulatory periods.
3. This process plays an important part in achieving an Optimal NEO Position as it:
  - Recognises the inability of DNSPs and the Australian Energy Regulator (**AER**) to forecast (at the time of a regulatory determination) all possible events which may affect the efficient costs incurred by a DNSP in providing electricity services
  - Provides a mechanism by which material changes in costs arising from such events can be dealt with so that DNSPs can recover at least their efficient costs of providing electricity services (per section 7A(2) of the National Electricity Law (**NEL**)) and thus promote efficient investment in and operation and use of the distribution system (per section 7A(3)(a) NEL)
  - Promotes the long term interests of consumers (per section 7 NEL) by:
    - Allowing the clear and transparent pass through of the specific costs arising from such events only if they are actually incurred, rather than requiring DNSPs to include an allowance for such costs in their regulatory proposal in the circumstance where the relevant event or events may not occur at all during the regulatory period
    - Protecting against a potential diminution of—or long term adverse impact on—electricity services if material expenditure is required to rectify issues arising from an event where the DNSP has no available means of recovering such costs.
4. In order for this process to operate efficiently and appropriately it is necessary that any nominated pass through events are defined in a certain and transparent manner. A failure to do so will not deliver regulatory certainty and transparency. A lack of regulatory certainty and transparency may impact efficient investment in the electricity system which in turn is likely to impact the price, quality, reliability and security of supply of electricity.<sup>2</sup> Thus a lack of certainty and transparency in the definition of nominated pass through events will not achieve an Optimal NEO Position.

## JEN NOMINATED PASS THROUGH EVENTS – APRIL 2015 SUBMISSION

5. After considering our unique operating environment and the risk mitigation strategies which may be available to us, JEN identified a number of events that we consider meet the nominated pass through event considerations.

<sup>2</sup> Australian Energy Market Commission, Rule Determination, National Electricity Amendment (Cost pass through arrangements for Network Service Providers) Rule 2012, Rule Proponent(s) Grid Australia, 2 August 2012, p 13

These events are:

- Insurance cap event—where the cost of an insurable event is greater than the benefit to be paid under the insurance policy
  - Insurance credit risk event—where an insurer becomes insolvent and JEN incurs higher or lower costs in the form of higher premiums, higher or lower deductibles or claim limits, or must absorb the cost of claims which would have been covered by the insurance policy issued by the insolvent insurer
  - Natural disaster event—any fire, flood, earthquake, or other natural disaster which increases the cost of providing direct control services
  - Terrorism event—any act which occurs for political, religious, ideological, ethical or similar purposes which increases the costs of providing direct control services
  - Retailer insolvency event—the failure of a retailer to pay JEN for the provision of direct control services
  - End of metering derogation event—costs incurred as a result of the expiry of the Victorian metering derogation and the introduction of metering contestability
  - Carbon cost event—the imposition of obligations under any carbon scheme.
6. JEN also proposed that pass through events apply to both standard control and alternative control services.
7. This submission maintains and builds upon JEN's April 2015 proposal. The April 2015 proposal (together with any supporting material contained or referred to in the April 2015 proposal) is incorporated into, and forms part of this submission.

## PRELIMINARY DECISION

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8. The preliminary decision indicated that the AER's approach was to assume that the DNSPs would adopt the most effective combination of four risk management strategies: prevention, mitigation, insurance and self-insurance. If a risk could not be managed efficiently in these ways, then the preliminary decision considered that a pass through event would apply to enable a DNSP to recover its efficient costs.
9. When considering whether to accept the nominated pass through events proposed by JEN, the AER indicated that it would take into account:
- Who is best placed to manage the risk
  - Consistency in approach across determinations
  - Interrelationships with other elements of the preliminary decision and how to balance incentive arrangements.
10. It is clear from recent decisions—including the preliminary decision—that the AER's approach has been to harmonise the description of nominated pass through events across energy network businesses. This is evident from the fact that—with some unexplained exceptions in the case of JEN which are highlighted below—the AER has largely adopted identical nominated pass through events across the preliminary determinations for the five Victorian electricity distribution businesses as well as in determinations in other jurisdictions.
11. Whilst this may seem to provide equality of treatment for all DNSPs, we believe that, in fact, this approach is not consistent with a proper consideration of the primacy of the businesses' proposals in a "propose/respond" regulatory process. It may also create different results in the treatment of DNSPs' across jurisdictions in a manner which would not promote the Optimal NEO Position. This submission discusses these issues further.

12. We carefully considered our unique operating environment and our ability to manage these events in a cost effective way, and identified a number of pass through events in addition to those provided for in the NER that we considered should not be included in the operating cost forecast. The preliminary decision assessed these events.
13. Table OV-1 above summarises our proposed nominated pass through events, the preliminary decision and JEN's submission.



## 1. INSURANCE CAP EVENT

### 1.1 JEN'S APRIL 2015 PROPOSAL

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14. JEN proposed an insurance cap event as a nominated pass through event because, despite its risk management and mitigation measures, circumstances that would fall within the scope of such an event:
- Are beyond JEN's control
  - Meet the nominated pass through considerations
  - Are generally high impact/low probability risk events where insurance coverage may not be available, or is only available on terms and conditions that are not commercially efficient and thus purchasing such cover would not result in an Optimal NEO Position.
15. JEN outlined its proposal in section 3.1.3 of Attachment 5-4 of its April 2015 proposal.

### 1.2 PRELIMINARY DECISION

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16. The preliminary decision accepted that an insurance cap event was consistent with the nominated pass through considerations as it would protect JEN from high cost impact events which it would be uneconomical to insure against. Consumers benefit because they are not required to fund excessive premiums where insurance, if available, would be uneconomic. Thus consumers are only required to bear the costs should the event occur.
17. However, in defining the insurance cap event, the preliminary decision amended JEN's proposed definition by including new factors which are additional to the nominated pass through considerations in the NER. The preliminary decision indicated the basis on which it included these factors was to:
- Address the efficiency of JEN's decision and actions
  - Address whether reasonable action had been taken to reduce the magnitude of the amount claimed
  - Provide certainty and transparency in the operation of the nominated pass through event.
18. The preliminary decision's amended definition allows the AER to have regard to the relevant insurance policy JEN has for the event and the level of insurance that an efficient a prudent DNSP would obtain in respect of such an event. The preliminary decision's amended definition also removed the reference to related parties being deemed to be JEN for the purpose of making a claim.
19. The definition included in the preliminary decision is:

*An insurance cap event occurs if:*

1. *Jemena makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy,*
2. *Jemena incurs costs beyond the relevant policy limit, and*
3. *the costs beyond the relevant policy limit materially increase the costs to Jemena in providing direct control services.*

*For this insurance cap event:*

4. *the relevant policy limit is the greater of:*
  - a. *Jemena's actual policy limit at the time of the event that gives, or would have given rise to a claim, and*
  - b. *the policy limit that is explicitly or implicitly commensurate with the allowance for insurance premiums that is included in the forecast operating expenditure allowance approved in the AER's final decision for the regulatory control period in which the insurance policy is issued.*
5. *A relevant insurance policy is an insurance policy held during the 2016–20 regulatory control period or a previous regulatory control period in which Jemena was regulated.*

*Note for the avoidance of doubt, in assessing an insurance cap event cost pass through application under rule 6.6.1(j), the AER will have regard to:*

- i. *the relevant insurance policy for the event, and*
- ii. *the level of insurance that an efficient and prudent NSP would obtain in respect of the event.*

### 1.3 JEN'S RESPONSE AND THIS SUBMISSION

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20. We welcome the preliminary decision's endorsement and acceptance that an insurance cap event is consistent with the nominated pass through considerations and should be included as a nominated pass through event. However we note the preliminary decision's proposed amended definition includes additional factors to those contained in the nominated pass through considerations definition in Chapter 10 of the NER.
21. We have incorporated the preliminary decision's position and its amended definition into this submission on the following bases:
  - We consider that it is consistent with the Optimal NEO Position to allow costs that JEN incurs for an insurance cap event
  - JEN considers that the factors contained in paragraph (d) of the definition of "nominated pass through event considerations" in the NER relating to insurance are adequate and appropriate without the need for the additional factors to be included in the insurance cap event definition itself. However we have incorporated the preliminary decision's revised definition in this submission on the basis that:
    - The altered definition does not substantially alter the manner in which the nominated cost pass through event proposed by JEN is to operate
    - Having already approved JEN's opex allowance and considered what is the appropriate level of insurance cover (via the definition of "relevant policy limit" contained in paragraph 4 of the insurance cap event definition) the additional words included in the preliminary decision would not result in a pass through being denied on the basis of hindsight
    - The word "materially" included by the AER in the definition has the meaning set out in Chapter 10 of the NER.
22. We consider this interpretation is consistent with the NER and the Optimal NEO Position as the setting of a particular level of operating expenditure allowance includes, explicitly or implicitly, the setting of the level of insurance that a DNSP is able to purchase given the revenue available and prevailing conditions in the insurance market. Thus it would be inconsistent with the Optimal NEO Position for the AER to then assert that

JEN should have obtained a different level of cover to that which it was able to purchase given the approved level of operating expenditure. Such a position would create uncertainty and a lack of transparency which is not consistent with an Optimal NEO Position for the reasons set out above.

23. Thus, subject to the matters set out above, the definition of the insurance cap event proposed by JEN in this submission is as follows (with the underline and strike through indicating the preliminary decision amendments):

*An insurance cap event occurs if:*

- a) *Jemena makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy,*
- b) *Jemena incurs costs beyond the relevant policy limit, and*
- c) *the costs beyond the relevant policy limit materially increase the costs to Jemena in providing direct control services.*

*For this insurance cap event:*

- a) *the relevant policy limit is the greater of:*
  - i. *Jemena's actual policy limit at the time of the event that gives, or would have given rise to a claim, and*
  - ii. *the policy limit that is explicitly or implicitly commensurate with the allowance for insurance premiums that is included in the forecast operating expenditure allowance approved in the AER's final decision for the regulatory control period in which the insurance policy is issued.*
- b) *A relevant insurance policy is an insurance policy held during the 2016–20 regulatory control period or a previous regulatory control period in which Jemena was regulated.*
- ~~a) the DNSP will be deemed to have made a claim on a relevant insurance policy if the claim is made by a related party of the DNSP in relation to any aspect of the DNSP's distribution network or the DNSP's business.~~

Note for the avoidance of doubt, in assessing an insurance cap event cost pass through application under rule 6.6.1(j), the AER will have regard to:

- a) the relevant insurance policy for the event, and
- b) the level of insurance that an efficient and prudent NSP would obtain in respect of the event.

24. If the AER does not agree with the interpretation of the effect of the preliminary decision's altered definition set out in this submission then JEN maintains the definition of this event as set out in our April 2015 proposal for the reasons set out in this submission and in our April 2015 proposal.

## 2. INSURER CREDIT RISK EVENT

### 2.1 JEN'S APRIL 2015 PROPOSAL

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25. JEN proposed an insurer credit risk event as a nominated pass through event because, despite its risk management and mitigation measures (including its business practice of taking reasonable precautions and actions to monitor the financial capabilities of insurers), the event:
- Is beyond JEN's control
  - Meets the nominated pass through considerations
  - Addresses the fact that a DNSP cannot anticipate or prevent the failure of an insurance provider.
26. JEN has outlined its proposal in section 3.1.2 of Attachment 5-4 of its April 2015 proposal.

### 2.2 PRELIMINARY DECISION

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27. The preliminary decision accepted that an insurer credit risk event is consistent with the nominated pass through considerations because the options available to DNSPs to manage these risks are limited and, given the rarity of such events, may in fact result in greater expenditure on insurance than is prudent and efficient.
28. However, the preliminary decision amended JEN's proposed definition by including factors additional to the nominated pass through considerations in Chapter 10 of the NER. The preliminary decision indicated that the reason for including those factors was to provide greater transparency in the operation of the nominated pass through event. More specifically, the preliminary decision considered the definition proposed by JEN was too broad in two respects:
- The JEN definition included an ability to recover any increase in JEN's insurance premium arising from such an event. The preliminary decision considered JEN is best placed to manage this risk as insurance premiums are a typical business expense, subject to ordinary market factors in the economy
  - The preliminary decision considered additional requirements should be included in the definition to limit recovery to costs specific to existing or potential claims to the failed insurer. This was necessary to ensure there was no incentive for JEN to delay the purchase of alternative insurance because it is able to recover the costs incurred prior to the establishment of new arrangements under the nominated pass through event.
29. The preliminary decision's amended definition thus only contemplates pass through of the following costs:
- Additional costs associated with funding a claim which would have otherwise been claimable under the insolvent insurer's policy
  - The higher or lower claim limit or higher or lower deductible than that which would otherwise have applied under the policy issued by the insolvent insurer.
30. The preliminary decision also included in the amended definition a note to the effect that, in assessing an insurer's credit risk event, the AER will have regard to JEN'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 whether JEN had a reasonable opportunity to insure the risk with a different provider.

31. The preliminary decision's proposed amended definition is:

*An insurer's credit risk event occurs if:*

- *a nominated insurer of Jemena 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, Jemena:*
  - *Is subject to a higher or lower claim limit or a higher or lower deductible than would have otherwise applied under the insolvent insurer's policy; or*
  - *incurs additional costs associated with funding an insurance claim, which would otherwise have been covered by the insolvent insurer.*

*Note: In assessing an insurer's credit risk event pass through application, the AER will have regard to, amongst other things:*

- *Jemena's attempts to mitigate and prevent the event from occurring by reviewing and considering the insurer's track record, size, credit rating and reputation*
- *In the event that a claim would have been made after the insurance provider became insolvent, whether Jemena had reasonable opportunity to insure the risk with a different provider.*

## 2.3 JEN'S RESPONSE AND THIS SUBMISSION

32. We welcome the preliminary decision's endorsement and acceptance that an insurer credit risk event is consistent with the nominated pass through considerations and should be included as a nominated pass through event.
33. JEN maintains our position that it is consistent with the Optimal NEO Position to allow JEN to recover amounts it incurs as the result of the failure of an insurance provider.

### 2.3.1 ISSUES ARISING FROM INSOLVENCY OF AN INSURER

34. When drafting our definition of insurer insolvency event JEN had regard to the circumstances which arose following the collapse of HIH and the provisional liquidation of United Medical Protection, as these events gave the best possible indication of the likely impacts JEN may face as a result of the failure of one of JEN's insurance providers.
35. Those impacts included:
- A large increase in insurance premiums (particularly for professional indemnity and public liability insurance). Following the collapse of HIH insurance premiums rose significantly and such increases were sustained over time<sup>3</sup>. Premiums for professional indemnity insurance were reported to have increased by as much as 1000% per year<sup>4</sup> and for public liability insurance ranging up to 900%<sup>5</sup>

<sup>3</sup> Source: The Australian Government The Treasury, Economic Roundup Issue 1, 2015, paragraph 3.2.

<sup>4</sup> Source: The Australian Government The Treasury, Economic Roundup Issue 1, 2015, paragraph 3.2.

<sup>5</sup> Source: The Australian Government The Treasury, Economic Roundup Issue 1, 2015, paragraph 3.2.

- Insurers were unwilling to underwrite insurance for certain activities or were only prepared to do so at unaffordable prices<sup>6</sup>
  - The remaining insurance market was unable to instantly fill the void<sup>7</sup> resulting in delays in the ability to obtain replacement cover<sup>8</sup>
  - Claims under policies with the insolvent insurers were not honoured
  - The remaining insurance market did not provide cover for risks previously insured under the policy with the insolvent insurer
  - Insureds were not able to obtain the same level of cover or the same deductible levels for a comparable premium and thus had to accept lower limits of cover or a higher premium in any replacement policy.
36. Taking these impacts into account in our April 2015 proposal JEN drafted the insurer credit risk event definition so that all of these likely additional costs were included in the nominated pass through event. This was to ensure that, if such an event were to occur, JEN would be able to recover the efficient costs it would incur due to an insurer credit risk event.

### 2.3.2 ISSUES ARISING FROM THE PRELIMINARY DECISION

#### 2.3.2.1 Failure to include recovery of additional premium costs

37. We do not consider that the preliminary decision to amend the event definition to exclude the recovery of higher or lower costs associated with insurance premiums results in an Optimal NEO Position for the following reasons:
- The preliminary decision justifies the exclusion of this item on the basis that insurance premiums are a typical business expense, subject to ordinary market forces, which businesses are best placed to manage. However, JEN considers that if such an event were to occur, the insurance premiums available in the marketplace subsequent to the event are unlikely to be a typical business expense subject to ordinary factors. This is why this event has been proposed (and accepted in the preliminary decision) as being consistent with the nominated pass through considerations. The potential for these costs to be extraordinary and atypical is outlined by the Australian Government Treasury when outlining the implications of the collapse of HIH on premiums:

*“...HIH’s collapse catalysed large premium increases in certain insurance classes, most notably in professional indemnity and public liability insurance...”*

*“A 2002 review of insurance industry market pricing by the Australian Competition and Consumer Commission (ACCC) concluded that the HIH collapse had led to large and sustained insurance premium increases...”*

*“This repricing occurred against the backdrop of a global ‘hardening’ in insurance markets triggered by the events of 11 September 2001 in the US, a series of large-scale natural disasters, and the*

<sup>6</sup> Based on: Dutton P. (then Minister for Revenue and Assistant Treasurer) Available and Affordable: Improvements in liability insurance following tort law reform in Australia, Commonwealth of Australia, Canberra, December 2006 p 5.

<sup>7</sup> Based on: Dutton P. (then Minister for Revenue and Assistant Treasurer) Available and Affordable: Improvements in liability insurance following tort law reform in Australia, Commonwealth of Australia, Canberra, December 2006 p 5.

<sup>8</sup> Based on The Australian Government The Treasury, Economic Roundup Issue 1, 2015, paragraph 3.1.

*bursting of the ‘dot-com’ bubble — which in turn fostered a decline in global equity markets and in the investment returns earned by insurers...<sup>9</sup>*

This shows that the impact of the failure of an insurer can be serious, wide ranging and driven by many factors, all of which are beyond the reasonable control of a DNSP. Thus categorising an insurance premium as a “typical business expense” subject to “ordinary” market forces where an insurer credit risk event has occurred does not appear to reflect the market conditions that have in fact existed when such insurer credit risk events have occurred in the past.

- The insolvency of an insurer will result in JEN incurring additional premium costs in a number of ways:
    - First, JEN is unlikely to receive any refund for premiums already paid to the insolvent insurer and thus JEN will have to incur the costs of purchasing insurance twice, once with the insolvent insurer and for a second time with a replacement insurer. So even if insurance was available on the same terms as the policy with the insolvent insurer, JEN would still be required to pay an amount for the insurance twice
    - Second, based on past experience (as indicated above) JEN may also have to pay a significantly higher amount to obtain the same (or potentially much lower) insurance cover to that provided under the insolvent insurer’s policy.
38. Not including this element in the pass through event definition is therefore likely to result in JEN not being able to recover the efficient costs it is likely to incur as a result of an insurer credit risk event.
39. This position is also impacted by the AER including in its amended definition a note that it will take into account (in assessing any claim under the insurer credit pass through event) whether JEN had a reasonable opportunity to insure the risk with another provider. This could force a DNSP into a position of either:
- Having to take out insurance at significantly inflated rates in order to maintain coverage (without undertaking a prudent assessment of available options and costs) or
  - Not taking out replacement insurance and potentially being unable to recover costs in respect of matters that would otherwise have been covered by the insolvent insurer, due to the application of the AER criteria in the amended definition of the insurer credit risk event.
40. In both cases, JEN would not be able to recover its efficient costs arising from the failure of its insurance provider.
41. This may also mean that the preliminary decision’s amended definition is in conflict with paragraph (d) of the nominated pass through event considerations definition in Chapter 10 of the NEL. This is because it may deny a DNSP a reasonable opportunity to make an assessment about whether it would be efficient to take out insurance or to self-insure until such a time as insurance was obtainable on reasonable commercial terms.
42. Such a result would not be consistent with section 7A(2) of the NEL and would not promote the Optimal NEO position.
43. JEN, therefore, proposes that the ability to claim the higher or lower costs of insurance premiums than those allowed in the distribution determination be reinstated into the definition of the insurer credit risk event.

### 2.3.2.2 Inclusion of non-exhaustive list of additional requirements

44. In the amended definition in the preliminary decision the AER has included a note that it will have regard to a number of factors “...amongst other things...” in assessing an insurer credit risk pass through event application.

<sup>9</sup> The Australian Government The Treasury, Economic Roundup Issue 1, 2015, paragraph 3.2.



The preliminary decision provided no guidance as to what these “*other things*” may be, nor did the preliminary decision provide any indication of how including a non-exhaustive list of factors promotes the NEO.

45. JEN considers that including these words in a note which accompanies a nominated pass through definition is not consistent with the Optimal NEO Position because this wording:
- Is not clear and transparent as it does not identify the “other things” the AER may have regard to
  - Does not promote regulatory certainty and thus may impact efficient investment in the electricity system which may in turn lead to other impacts on the NEO as referred to above
  - Is not consistent with the definition of nominated pass through considerations in Chapter 10 of the NER which provides that the nominated pass through considerations are “*any other matter the AER considers relevant and which the AER has notified Network Service Providers is a nominated pass through event consideration.*” (emphasis added)
46. The addition of the words “*amongst other things*” therefore does not provide certainty or transparency and, for the reasons set out above, it does not achieve an Optimal NEO Position. Jen considers that the words “*amongst other things*” should be removed from the insurer credit risk event definition.

### 2.3.2.3 Inclusion of a requirement to mitigate and prevent the event by monitoring the insurer

47. The preliminary decision has included in the amended definition a note that the AER will take into account Jemena’s attempts to mitigate or prevent the event from occurring by reviewing and considering the insurer’s track record, size, credit rating and reputation.
48. Such monitoring is undertaken by JEN on a regular basis, however, such steps would not prevent the insurer from becoming insolvent. Other than taking out multiple insurance policies to cover the same risks in the event of any concern about any of its insurers (which may result in a greater expenditure on insurance than is prudent or efficient), we cannot see what a DNSP could do to mitigate or prevent this risk event.
49. Further, a Royal Commission established by the Australian Government to inquire into the reasons for, and the circumstances surrounding, the failure of HIH found evidence of:

*“...complex and questionable reinsurance arrangements<sup>31</sup> and aggressive accounting methods used to disguise the true (precarious) financial position of HIH. It also uncovered evidence that some senior HIH personnel may have contravened corporations laws.<sup>10</sup>*

50. It would be inappropriate to expect JEN to have, tools in place to identify misleading conduct or illegal actions being undertaken by its insurers.
51. We therefore cannot see how the addition of this requirement provides certainty or transparency as to the application of this event or promotes the Optimal NEO Position.
52. This addition to the definition of insurer credit risk event should therefore be removed.

### 2.3.2.4 Inclusion of a requirement to consider whether JEN had a reasonable opportunity to insure the risk with a different provider

53. The preliminary decision has included in the amended definition a requirement that account be taken of whether JEN had a reasonable opportunity to insure the risk with a different provider. The preliminary decision says this

<sup>10</sup> [http://www.treasury.gov.au/PublicationsAndMedia/Publications/2015/Economic-Roundup-Issue-1/HTML/article-3/3-Aftermath-of-the-HIH-collapse#P119\\_21149](http://www.treasury.gov.au/PublicationsAndMedia/Publications/2015/Economic-Roundup-Issue-1/HTML/article-3/3-Aftermath-of-the-HIH-collapse#P119_21149), section 3.3.



is to limit the insurer credit risk to costs specific to existing or potential claims to the failed insurers so that JEN does not have an incentive to delay the purchase of alternative insurance.

54. It is not clear whether the preliminary decision is referring to claims arising from circumstances which occurred before, or after, the insurer became insolvent.
55. If the preliminary decision is referring to claims from circumstances which occur after the insurer becomes insolvent, as set out above, JEN may not be able—due to events beyond its control—to obtain replacement cover on reasonable terms or in a timely manner.
56. If the preliminary decision is referring to claims from circumstances which occurred before the insurer became insolvent, this involves an assumption that it would be possible for JEN to obtain cover from a subsequent insurer for such claims. Based on ordinary underwriting practices this is unlikely as subsequent insurers usually do not accept liability for claims which occurred prior to the subsequent insurer issuing cover (in the case of public liability insurance), or arose from known circumstances (in the case of professional indemnity insurance).
57. The addition of this requirement thus does not provide clarity or promote the Optimal NEO Position.
58. This addition of this requirement to the definition of insurer credit risk event should therefore be removed.

#### 2.3.2.5 Definition of Insurer Credit Risk event:

59. For the reasons set out in this submission and JEN's April 2015 proposal the Optimal NEO Position is achieved by the definition of insurer credit risk event set out below as such a definition:
  - Enables JEN to recover the efficient costs it incurs as a result of an insurer credit risk event, promotes efficient investment in electricity services and therefore promotes the Optimal NEO Position
  - Promotes the long term interests of consumers of electricity services by maintaining the flexibility of the nominated pass through event considerations (including allowing an assessment to be made as to whether obtaining replacement insurance cover is an effective cost) and protecting against a diminution of—or long term adverse impact on—electricity services which may result if JEN was not able to recover its effective costs of an insurer credit event.

Insurer Credit Risk Event means *the insolvency of the DNSP's insurer, as a result of which the DNSP:*

- a) *incurs higher or lower costs for insurance premiums than those allowed for in the distribution determination;*
- b) *in respect of a claim for a risk that would have been insured by the DNSP's insurers, is subject to materially higher or lower claim limit, or a materially higher or lower deductible than would have applied under that policy; or*
- c) *incurs additional costs associated with self -funding an insurance claim, which, would have otherwise been covered by the insolvent insurer.*

## 3. NATURAL DISASTER EVENT

### 3.1 JEN'S APRIL 2015 PROPOSAL

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60. JEN proposed a natural disaster event as a nominated pass through event because, despite its risk management and mitigation measures, the event:
- Is beyond JEN's control
  - Meets the nominated pass through considerations
  - Addresses a natural disaster risk which cannot be efficiently mitigated through external insurance (cost is prohibitive) and a self-insurance premium cannot be determined.
61. JEN outlined its proposal in section 3.1.1 of Attachment 5-4 of its April 2015 proposal.

### 3.2 PRELIMINARY DECISION

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62. The preliminary decision accepted that a natural disaster event was consistent with the nominated pass through considerations. However, the preliminary decision amended JEN's proposed definition by including factors additional to those contained in the nominated pass through considerations in Chapter 10 of the NER.
63. The preliminary decision indicated that the basis on which the AER included those factors was to reflect the extent to which a service provider could mitigate the cost impact of the event, to reflect whether the provider could insure against the event and to provide greater certainty and transparency in the operation of the nominated pass through event.
64. The preliminary decision amended definition:
- Included a note that, in assessing a natural disaster event, the AER will have regard to whether JEN had insurance against the event, the level of insurance an efficient and prudent NSP would obtain in respect of the event and whether a relevant government authority has made a declaration that a natural disaster has occurred
  - Added a requirement that the natural disasters be 'major' which is defined in the preliminary decision to mean serious and significant but not material as defined in the NER
  - Changed the definition to refer to standard control services rather than direct control services as proposed by JEN.
65. The preliminary decision's proposed amended definition is:

*A natural disaster event occurs if:*

*Any major fire, flood, earthquake or other natural disaster occurs during the 2016–20 regulatory control period and materially increases the costs to Jemena in providing standard control services, provided the fire, flood or other event was not a consequence of the acts or omissions of the service provider.*

*The term 'major' in the above paragraph means an event that is serious and significant. It does not mean material as that term is defined in the Rules (that is 1 per cent of the DNSP's annual revenue requirement for that regulatory year).*

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

- i. whether Jemena has insurance against the event,*
- ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event,*
- iii. whether a relevant government authority has made a declaration that a natural disaster has occurred.*

### 3.3 JEN'S RESPONSE AND THIS SUBMISSION

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66. We welcome the preliminary decision endorsing and accepting a natural disaster event as consistent with the nominated pass through considerations and that it should be included as a nominated pass through event.
67. JEN maintains that it is consistent with the Optimal NEO Position to allow JEN to recover amounts it incurs as the result of a natural disaster event.
68. We note however that the preliminary decision amends the definition of a natural disaster event to include the term 'major', refers to standard control services (rather than direct control services) and includes additional considerations - including whether a declaration of a natural disaster event has occurred.
69. JEN does not consider the amended definition in the preliminary decision achieves the Optimal NEO Position for the reasons set out below.

#### 3.3.1 INCLUSION OF THE TERM "MAJOR" AND DEFINITION OF THAT TERM

70. The preliminary decision states that amendments were made to the definition to refer to "major" natural disasters to make it clearer when the event will be taken to have occurred.
71. However this is not the case as the definition the of "major" contained in the preliminary decision:
  - Is not clear
  - Is potentially inconsistent with the NER
  - May lead to inconsistent results between DNSPs in circumstances where such inconsistencies are not justified.
72. Major is defined as 'serious and significant'. However, no further guidance is given in the preliminary decision as to what is meant by 'serious and significant' other than it is not 'material' as defined by the NER.
73. This leads to a lack of clarity and is unnecessary given the considerations specified in clause 6.6.1(j)(3) of the NER.
74. The preliminary decision's formulation of the definition also conflates the magnitude of the event with the cost impact of the event with two possible consequences, namely that "major" means less than "material" or major is greater than "material".
75. If "major" means an impact less than "material" (ie less than 1% of the DNSP's annual revenue requirement as "material" is defined in the NER) the inclusion of that term is redundant because the altered definition already

requires the natural disaster to ‘materially’ increase the costs to JEN of providing the services where ‘materially’ must be interpreted as consistent with the 1% threshold.

76. If “major” means greater than 1% of DNSP’s annual revenue requirement, then this would increase uncertainty and be inconsistent with the legislated threshold levels and therefore inconsistent with the NER.
77. The addition of the word “major” thus does not provide certainty or transparency and, for the reasons set out above, it does not achieve an Optimal NEO Position and should be removed.

### 3.3.2 INCLUSION OF NON-EXHAUSTIVE LIST OF ADDITIONAL REQUIREMENTS

78. In the amended definition the preliminary decision notes that the AER will have regard to a number of factors “...*amongst other things*...” in assessing a natural disaster pass through event application. The preliminary decision provided no guidance as to what these “*other things*” may be, nor did it provide any indication of how including a non-exhaustive list of factors promotes the NEO.
79. JEN considers that including these words in a note which accompanies a nominated pass through definition is not consistent with the Optimal NEO Position because this wording:
  - Is not clear and transparent as it does not identify the “other things” the AER may have regard to
  - Does not promote regulatory certainty and thus may impact efficient investment in the electricity system which may in turn lead to other impacts on the NEO as referred to above
  - Is not consistent with the definition of nominated pass through considerations in Chapter 10 of the NER which provides that the nominated pass through considerations are “*any other matter the AER considers relevant and which the AER has notified Network Service Providers is a nominated pass through event consideration.*” (*emphasis added*)
80. The addition of the words “*amongst other things*” therefore does not provide certainty or transparency and, for the reasons set out above, it does not achieve an Optimal NEO Position and the words should be removed.

### 3.3.3 INCLUSION OF INSURANCE REQUIREMENTS

81. JEN considers that including a requirement to consider whether JEN has insurance for a natural disaster event and the level of such insurance in assessing a pass through event application is not consistent with an Optimal NEO Position for the following reasons:
  - The preliminary decision accepts that a DNSP may incur costs under this event which an insurance policy would not ordinarily cover
  - To the extent insurance cover is relevant it is already dealt with by paragraph (d) of the definition of nominated pass through considerations in Chapter 10 of the NER, and also via the considerations specified in clause 6.6.1(j)(3) of the NER
  - The setting of a particular level of operating expenditure allowance includes, explicitly or implicitly, the setting of the level of insurance that a DNSP can purchase given the revenue available and prevailing conditions in the insurance market. It is inconsistent with the Optimal NEO Position for the preliminary decision to then assert that JEN should have obtained a different level of cover to that which it was able to purchase given the approved level of operating expenditure.
82. JEN believes the NER already provides sufficient criteria for the assessment of a DNSPs insurance cover and the adding of further criteria is redundant and unnecessary.

83. The addition of these requirements therefore does not provide certainty or transparency and, for the reasons set out above, these additions do not achieve an Optimal NEO Position and the words should be removed.

### 3.3.4 INCLUSION OF REQUIREMENT FOR A DECLARATION OF NATURAL DISASTER

84. The preliminary decision states that a factor the AER will consider when assessing whether to approve a natural disaster pass through event is whether a relevant government authority had made a declaration that a natural disaster has occurred.
85. JEN considers the addition of this requirement does not promote the Optimal NEO Position for the following reasons:
- The additional requirement may lead to inconsistent application of the pass through event across jurisdictions. This is because the legislation around the declaring of natural disasters is not uniform across Australian States and Territories. For example, some States have only one level of alert, some have a hierarchy of alerts. Some States refer to the declaration of a disaster, some refer to a state of emergency and some to a major incident or major emergency.<sup>11</sup> This may lead to confusion, and different treatment, of events depending upon which jurisdiction the event occurred in. This confusion may be exacerbated by the fact that in some States the form of the declaration is of a “major incident” or a “major emergency” which could be problematic given the use of the term “major” by the AER in the natural disaster event definition. Thus the addition of this factor does not achieve the aim set out in the preliminary decision of ensuring consistency in its approach across its determinations
  - It is difficult to see, and the preliminary decision provides no reasons to support, how the declaring of a natural disaster by a government authority impacts, or is otherwise relevant to, the achievement of an Optimal NEO Position. The declaring of a natural disaster is an administrative procedure which triggers certain emergency powers of various government agencies (ie rights of entry, rights to control the movement of people etc) and potentially grants access to certain limited disaster relief emergency payments. The preliminary decision has not indicated how this is relevant to the principles underpinning the NEO and thus why the declaration (or otherwise) of a natural disaster should form a basis on which to determine whether a DNSP should be entitled to recover its efficient costs arising from a natural disaster event. Adding such a consideration would therefore mean that the AER could be making a decision on a pass through application based on an irrelevant consideration, namely, the triggering of an administrative process rather than focusing on the cost impact to the DNSP of the event and the other NEO criteria.
86. The addition of this requirement therefore does not provide certainty or transparency and, for the reasons set out above, it does not achieve an Optimal NEO Position and the words should be removed.

### 3.3.5 APPLICATION OF PASS THROUGH EVENT TO DIRECT CONTROL SERVICES

87. The preliminary decision amended the definition of natural disaster event so that it applies to standard control services rather than direct control services as proposed by JEN.
88. This decision is inconsistent with the preliminary decision to approve JEN’s proposal that the pass through events should apply to both standard control services and alternative control services.
89. The preliminary decision provided no reasons for altering the definition from direct control services to standard control services.

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<sup>11</sup> See for example the Ready Reference contained in Michael Eburn, *Emergency Law, - Rights, liabilities and duties of emergency workers and volunteers*, 4<sup>th</sup> Edition, 2013, The Federation Press, Appendix.

90. JEN notes that this decision is different from the preliminary decisions made for all other DNSPs in Victoria and in other jurisdictions in relation to the natural disaster nominated pass through event. JEN can see no reason why it should be treated differently to other DNSPs in relation to this pass through event and thus does not consider that this decision is consistent with the Optimal NEO Position.
91. JEN considers that the pass through should apply to direct control services and the definition of natural disaster event should be revised accordingly.

### 3.3.6 CONCLUSION

92. For the reasons set out in this submission and JEN's April 2015 proposal the Optimal NEO Position is achieved by the definition of natural disaster event set out below because such a definition:
  - Is certain and transparent and complies with the nominated pass through considerations
  - Enables JEN to recover its effective costs of a natural disaster risk event and thus promotes efficient investment in electricity services
  - Promotes the long term interests of consumers of electricity services by maintaining the flexibility of the nominated pass through event considerations and protecting against a diminution of—or long term impact on—electricity services which may result if JEN was not able to recover its effective costs of natural disaster event.

93. **JEN's proposed definition:**

*Any fire, flood, earthquake, or other natural disaster that occurs during the forthcoming regulatory control period and increases the costs to the DNSP of providing direct control services.*

## 4. TERRORISM EVENT

### 4.1 JEN'S APRIL 2015 PROPOSAL

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94. JEN proposed to include a terrorism event as a nominated pass through event because, despite its risk management and mitigation measures, the event:
- Is beyond JEN's control
  - Meets the nominated pass through considerations
  - Addresses the risk arising from acts of terrorism which cannot be efficiently mitigated through external insurance (cost is prohibitive) and a self- insurance premium cannot be determined.
95. JEN outlined its proposal in section 3.1.4 of Attachment 5-4 of its April 2015 proposal. JEN maintains the claims for confidentiality contained in the April 2015 proposal.

### 4.2 PRELIMINARY DECISION

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96. The preliminary decision accepted that a terrorism event was consistent with the nominated pass through provisions as JEN's ability to forecast either the occurrence or cost impact of a terrorism event is limited.
97. However, the preliminary decision amended JEN's proposed definition by including factors additional to the nominated pass through considerations in the NER.
98. The AER indicated the basis on which it included these factors was to reflect the extent to which a service provider could mitigate the cost impact of the event, could insure against the event and to include a narrow and more clearly defined terrorism event.
99. The preliminary decision's amended definition:
- Included a note that, in assessing a terrorism event, the AER will have regard to, amongst other things, whether JEN had insurance against the event, the level of insurance an efficient and prudent NSP would obtain in respect of the event and whether a relevant government authority has made a declaration that a terrorism event has occurred
  - Added a requirement that the event "materially" increase the costs to JEN
  - Changed the definition to refer to standard control services rather than direct control services as proposed by JEN.
100. The preliminary decision's proposed amended definition is:

*A terrorism event occurs if:*

*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 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 materially increases the costs to Jemena in providing standard control services.*



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

- i. whether Jemena has insurance against the event;*
- ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event; and*
- iii. whether a declaration has been made by a relevant government authority that a terrorism event has occurred.*

### 4.3 JEN'S RESPONSE AND THIS SUBMISSION

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101. We welcome the preliminary decision endorsing and accepting that a terrorism event is consistent with the nominated pass through considerations and should be included as a nominated pass through event.
102. JEN affirms, and maintains, its position that it is consistent with the Optimal NEO Position to allow JEN to recover amounts it incurs as the result of a terrorism event.

#### 4.3.1 INCLUSION OF TERM "MATERIALLY" IN THE DEFINITION

103. We note the preliminary decision included the term 'materially' in the definition. We have assumed for the purposes of this submission that the intent is that this term will have the meaning set out in Chapter 10 of the NER. If this is not the case and it is intended that the word "materially" is to have a different meaning to that in the NER JEN considers that would not promote certainty and transparency and would not promote an Optimal NEO Position and should be removed from the definition.

#### 4.3.2 INCLUSION OF NON-EXHAUSTIVE LIST OF ADDITIONAL REQUIREMENTS

104. In the amended definition the preliminary decision notes that the AER will have regard to a number of factors "...amongst other things..." in assessing a terrorism pass through event application. The preliminary decision has provided no guidance as to what these "other things" may be, nor did the preliminary decision provide any indication as to how including such a non-exhaustive list of factors promotes the NEO.
105. JEN considers that including these words in a note which accompanies a nominated pass through definition is not consistent with the Optimal NEO Position because this wording:
  - Is not clear and transparent as it does not identify the "other things" the AER may have regard to
  - Does not promote regulatory certainty and thus may impact efficient investment in the electricity system which may in turn lead to other impacts on the NEO as referred to above
  - Is not consistent with the definition of nominated pass through considerations in Chapter 10 of the NER which provides that the nominated pass through considerations are "*any other matter the AER considers relevant and which the AER has notified Network Service Providers is a nominated pass through event consideration.*" (emphasis added)
106. The addition of the words "*amongst other things*" therefore does not provide certainty or transparency and, for the reasons set out above, it does not achieve an Optimal NEO Position and the words should be removed.



### 4.3.3 INCLUSION OF INSURANCE REQUIREMENTS

107. JEN considers that having regard to whether JEN has insurance for a terrorism event and the level of such insurance in assessing a pass through event application is not consistent with an Optimal NEO Position for the following reasons:
- The preliminary decision accepts that a DNSP may incur costs under this event which an insurance policy would not ordinarily cover
  - To the extent insurance cover is relevant it is already dealt with by paragraph (d) of the definition of nominated pass through considerations in Chapter 10 of the NER, and also via the considerations specified in clause 6.6.1(j)(3) of the NER
  - As indicated above, the setting of a particular level of operating expenditure allowance includes, explicitly or implicitly, the setting of the level of insurance that a DNSP can purchase given the revenue available and prevailing conditions in the insurance market. Thus it would be inconsistent with the Optimal NEO Position for the AER to then assert that JEN should have obtained a different level of cover to that which it was able to purchase given the approved level of operating expenditure.
108. JEN believes the NER already provides sufficient criteria for the assessment of a DNSPs insurance cover and the adding of further criteria is redundant and unnecessary. The addition of these requirements therefore does not provide certainty or transparency and, for the reasons set out above, it does not achieve an Optimal NEO Position and the requirement should be removed.

### 4.3.4 INCLUSION OF REQUIREMENT FOR A DECLARATION OF TERRORISM

109. The preliminary decision states that a factor the AER would consider when assessing whether to approve a natural disaster pass through event is whether a relevant government authority had made a declaration that a terrorism event has occurred.
110. JEN considers the addition of this requirement does not promote the Optimal NEO Position for the following reasons:
- The additional requirement may lead to inconsistent application of the event across jurisdictions. This is because the legislation governing the declaring of a terrorism event is not uniform across Australian States and Territories. Thus the inclusion of this requirement does not achieve the aim set out in the preliminary decision of ensuring consistency in approach across determinations
  - The preliminary decision provides no reasons to support how the declaring of a terrorism event by a government authority impacts, or is otherwise relevant to, the achievement of an Optimal NEO Position. The declaring of a terrorism event is an administrative procedure which triggers certain powers of government agencies (ie rights of entry, rights to control the movement of people etc) and potentially grants rights under the *Terrorism Insurance Act 2003 (Cth)* in limited circumstances. The preliminary decision did not indicate how this is relevant to the principles underpinning the NEO and thus why the declaration (or otherwise) of a terrorism event should be used to determine whether a DNSP should be entitled to recover its efficient costs arising from a terrorism event. Adding such a consideration would therefore mean that the AER could be making a decision on a pass through application based on an irrelevant consideration, namely the triggering of an administrative process rather than focusing on the cost impact to the DNSP of the event and the other NEO criteria.
111. The addition of this requirement therefore does not provide certainty or transparency and, for the reasons set out above, it does not promote an Optimal NEO Position and the requirement should be removed.

#### 4.3.5 APPLICATION OF PASS THROUGH EVENT TO DIRECT CONTROL SERVICES

112. The preliminary decision has amended the definition of terrorism event so that it applies to standard control services rather than direct control services as proposed by JEN.
113. This decision is inconsistent with the AER's decision to approve JEN's proposal that the pass through events should apply to both standard control services and alternative control services. The preliminary decision has provided no reasons for altering the definition from direct control services to standard control services.
114. JEN notes that this decision is different from the preliminary decisions made for all other DNSPs in Victoria and in other jurisdictions in relation to the terrorism nominated pass through event. JEN can see no reason why it should be treated differently to other DNSPs in relation to this pass through event and thus does not consider that this decision is consistent with the Optimal NEO Position.
115. JEN considers that the pass through should apply to direct control services and the definition of terrorism event should be revised accordingly.

#### 4.3.6 CONCLUSION

116. For the reasons set out in this submission and JEN's April 2015 proposal the Optimal NEO Position is achieved by the definition of natural disaster event set out below as such a definition:
- Is certain and transparent and complies with the nominated pass through considerations
  - Enables JEN to recover its effective costs of a natural disaster risk event and thus promotes efficient investment in electricity services
  - Promotes the long term interests of consumers of electricity services by maintaining the flexibility of the nominated pass through event considerations and protecting against a diminution of—or long term impact on—electricity services which may result if JEN was not able to recover its effective costs of terrorism event.
117. **JEN's proposed definition**

*A 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 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 the DNSP in providing direct control services, to the extent those costs are not recovered from a third party.*

## 5. RETAILER INSOLVENCY EVENT

### 5.1 JEN'S APRIL 2015 PROPOSAL

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118. JEN proposed a retailer insolvency event as a nominated pass through event because, despite its risk management and mitigation measures, the event:
- Is beyond JEN's control
  - Meets the nominated pass through considerations, and
  - Addresses a retailer insolvency event. This is necessary as the retailer insolvency event outlined in the NER does not apply to Victorian DNSPs as the National Energy Customer Framework (**NECF**) has not been adopted in Victoria.
119. JEN outlined its proposal in section 3.1.6 of Attachment 5-4 of its April 2015 proposal.

### 5.2 PRELIMINARY DECISION

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120. The preliminary decision accepted that it would be appropriate to provide equivalent protection under the NECF to Victorian distribution businesses for a retailer insolvency event.
121. However, the preliminary decision amended JEN's proposed definition (which was drawn from a rule change proposal currently under consideration by the Australian Energy Market Commission (**AEMC**)) as the AER considered the outcome of the AEMC review is unknown and thus there was a risk that a nominated pass through in accordance with JEN's proposed definition would be inconsistent with that applied in other jurisdictions.
122. The preliminary decision altered the definition to refer to the NER event as in force from time to so that changes to the NER prescribed retailer insolvency event will apply as they take effect.
123. The preliminary decision's amended definition is:

*Prior to the commencement of the National Energy Customer Framework in Victoria, retailer insolvency event has the meaning set out in the NER as in force from time to time.*

*Note: This retailer insolvency event will cease to apply as a nominated pass through event on commencement of the National Energy Customer Framework in Victoria.*

### 5.3 JEN'S RESPONSE AND THIS SUBMISSION

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124. We welcome the preliminary decision endorsing and accepting that a retailer insolvency event is consistent with the nominated pass through considerations and should be included as a nominated pass through event.
125. JEN affirms, and maintains, its position that it is consistent with the Optimal NEO Position to allow JEN to recover amounts it incurs as the result of a retailer insolvency event.

126. We note the preliminary decision's position is to ensure the nominated pass through event is the same as that provided for in the NECF, and that the NECF may change from time to time—and therefore the preliminary decision reflected this in its amended definition of the retailer insolvency event.
127. We have incorporated the preliminary decision's position and the amended definition into this submission on the following bases:
- The definition in the preliminary decision only applies until such time as the National Energy Retail Law set out in the Schedule to the *National Energy Retail Law (South Australia) Act 2010* (as amended from time to time) is applied as Victoria
  - The term 'retailer' means a holder of a licence to sell electricity under the *Electricity Industry Act 2000 (Vic)*
  - Any amendments to the materiality threshold applicable to this event that arise as a result of a change to the NER (including via a rule change by AEMC) shall apply to this nominated pass through event.
128. We consider this interpretation would be consistent with the Optimal NEO Position.

If the AER does not accept the interpretation set out in this submission then JEN retains the definition set out in our April 2015 proposal for the reasons set out in this submission and in our April 2015 proposal.

## 6. END OF METERING DEROGATION EVENT

### 6.1 JEN'S APRIL 2015 PROPOSAL

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129. JEN proposed an end of metering delegation event as a nominated pass through event because, despite its risk management and mitigation measures, the event is:
- Beyond JEN's control
  - Meets the nominated pass through considerations
  - Addresses the risk arising from the end of the Victorian derogation from the metering provisions of chapter 7 of the NER and the introduction of metering contestability.
130. The derogation was intended to allow for the rollout of advance metering infrastructure (**AMI**) in Victoria by distribution businesses to small electricity consumers.
131. JEN anticipated that it would have to implement new, or change existing, systems and processes to be ready for the end of the Victorian derogation and new metering contestability framework that might be associated with new and updated procedures, ring fencing guidelines, requirements for registering as a Metering Coordinator and standard retailer contracts.
132. JEN outlined its proposal in section 3.1.7 of Attachment 5-4 of its April 2015 proposal.

### 6.2 PRELIMINARY DECISION

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133. The preliminary decision indicated:
- That the end of the Victorian derogation from the metering provisions under chapter 7 of the NER and the introduction of metering contestability would be covered under the regulatory change event or a service standard event depending on the final form the framework takes
  - It did not consider the costs that might be incurred prior to the expiry of the derogation because JEN did not provide further information about what these costs would be
  - It did not consider that it was appropriate for DNSPs to recover from their monopoly consumers the cost of upgrading IT systems required to compete with third party metering providers
134. The preliminary decision also commented that:

*“If a NSP incurs costs prior to the expiration of the derogation, in preparation for metering contestability, the NSP should bear the costs. NSPs were aware in advance that the derogation was ending, as part of normal business operation they should be prepared to respond to changes in the marketplace.”<sup>12</sup>*

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<sup>12</sup> AER, *Preliminary decision Jemena distribution determination 2016-2020, Attachment 15 – Pass through events*, October 2015, p 15-18.

### 6.3 JEN'S RESPONSE AND THIS SUBMISSION

135. We note the preliminary decision's position is that the end of metering derogation event costs would be covered under the regulatory change event or the service standard event. In reliance upon the preliminary decision we have not proposed a specific cost pass through event in this submission on the understanding that these costs would be considered as within the scope of a regulatory change event or a service standard event (subject to the materiality threshold).
136. At the time of lodging the April 2015 proposal JEN was not in a position to quantify the cost as the rule change<sup>13</sup> associated with the end of metering derogation was not finalised. Given the high levels of uncertainty at the time it was more appropriate to seek cost recovery through a pass through arrangement rather than as an estimate in the building block mode. Cost recovery through the pass through a mechanism in an environment of uncertainty is also supported by our customers (see Attachment 4-1, page 49 of our April 2015 proposal).
137. Since lodging our April 2015 proposal the AEMC finalised its rule change "Expanding competition in metering and related services" which has given us an opportunity to better estimate the magnitude of costs for providing distribution services in a contestable metering environment. With greater certainty we are now seeking to recover these costs through our opex and capex forecast (see Attachment 7-1 and Attachment 8-1 of this submission).
138. If this submission is not accepted we consider that it is consistent with the Optimal NEO Position to allow costs which JEN incurs to implement new, or change existing, systems and processes to be ready for the end of the Victorian derogation and the new metering contestability framework as:
- It would enable JEN to recover at least our efficient costs of providing electricity services (per section 7A(2) of the NEL) and thus promote efficient investment in the electricity distribution system (per section 7A(3)(a) NEL)
  - It would promote the long term interests of consumers (per section 7 NEL) by:
    - Allowing the clear and transparent pass through of the specific costs arising from such events only if they are actually incurred, rather than requiring DNSPs to include an allowance for such costs in their regulatory proposal in the circumstance where the relevant event or events may not occur at all during the regulatory period
    - Protecting against a potential diminution of—or long term adverse impact on—electricity services if material expenditure is required to rectify issues arising from an event where the DNSP has no available means of recovering such costs.
139. By way of clarification, JEN did not propose that it recover costs associated with competing with third party metering providers. The costs JEN would seek to pass through under the regulatory change event relate to the specific requirements of the relevant rules, procedures, and guidelines that impact on the costs of a DNSP in interacting with the market when providing electricity distribution services. Put simply, these are costs that JEN would incur as a DNSP irrespective of whether it was a participant in the contestable metering market.
140. JEN does not agree with the preliminary decision that costs incurred by JEN prior to the expiration of the derogation in preparation for metering contestability should be borne by JEN because they are part of normal business operations. It is not consistent with the NER and the AER's approach to applying the NER in relation to capex and opex forecasting, incentive schemes or cost pass through arrangements for the efficient costs incurred as a result of a change in a regulatory obligation to be borne by JEN alone. Costs associated with a change in an obligation are not part of normal business operations and should be incorporated in the price

<sup>13</sup> AEMC, *Rule determination, National Electricity Amendment (Expanding competition in metering and related services) Rule 2015 & National Energy Retail Amendment (Expanding competition in metering and related services) Rule 2015*, 26 November 2015

consumers pay for distribution service. If they are not incorporated then, contrary to section 7A(2) of the NEL, JEN would not be able to recover at least its efficient costs of providing electricity services and this would not promote an Optimal NEO Position.

## 7. CARBON COST EVENT

### 7.1 JEN'S APRIL 2015 PROPOSAL

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141. JEN proposed a carbon cost event as a nominated pass through event because, despite its risk management and mitigation measures, the event:
- Is beyond JEN's control
  - Meets the nominated pass through considerations
  - Addresses the uncertainty regarding carbon policy - and that any risk mitigation measure is not feasible due to the nature of the risk.
142. JEN outlined its proposal in section 3.1.5 of Attachment 5-4 of its April 2015 proposal.

### 7.2 PRELIMINARY DECISION

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143. The preliminary decision considered that the carbon cost event would be covered by one of the prescribed pass through events such as the regulatory change event or the tax change event.

### 7.3 JEN'S RESPONSE AND THIS SUBMISSION

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144. We note the preliminary decision's position is that a carbon cost event would be covered under one of the prescribed pass through events such as the regulatory change event or the tax change event.
145. In reliance upon the preliminary decision we have not proposed a specific cost pass through event on the understanding that these costs would be considered as a regulatory change event or a tax change event.
146. We consider that it is consistent with the Optimal NEO Position to allow costs which JEN incurs to as a result of any carbon cost event because:
- It would enable JEN to recover at least our efficient costs of providing electricity services (per section 7A(2) of the NEL) and thus promote efficient investment in the electricity system (per section 7A(3)(a) NEL)
  - It would promote the long term interests of consumers (per section 7 NEL) by:
    - Allowing the clear and transparent pass through of the specific costs arising from such events only if they are actually incurred rather than requiring DNSPs to include an allowance for such costs in their regulatory proposal in the circumstance where the relevant event or events may not occur at all during the regulatory period
    - Protecting against a potential diminution of—or long term adverse impact on—electricity services if material expenditure is required to rectify issues arising from an event where the DNSP has no available means of recovering such costs.



## 8. APPLICATION TO ALTERNATIVE CONTROL SERVICES

### 8.1 JEN'S APRIL 2015 PROPOSAL

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147. JEN proposed that the pass through events apply to both standard control services and alternative control services because JEN considers that would be consistent with the nominated pass through considerations and necessary to achieve the Optimal NEO Position.
148. JEN has outlined its proposal in paragraph 5, section 1 of Attachment 5-4 of its April 2015 proposal.

### 8.2 PRELIMINARY DECISION

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149. The preliminary decision accepted the application of nominated pass through events to direct control services and stated that JEN may apply to pass through an increase (or decrease) in costs incurred in providing both standard and alternative control services.
150. The preliminary decision agreed that this was consistent with the prescribed pass through events definitions set out in the NER which also references direct control services.

### 8.3 JEN'S RESPONSE AND THIS SUBMISSION

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151. We welcome the preliminary decision endorsing and accepting that pass through events should apply to direct control services (encompassing both standard control services and alternative control services) and that this is consistent with the prescribed pass through event definitions.
152. However as noted above (and inconsistent with the position in this aspect of the preliminary decision), the preliminary decision defined the natural disaster event and the terrorism event so as to only apply to an increase in standard control costs.
153. The preliminary decision provided no reasons, or evidence, as to why the definitions of these events should be restricted to a claim for an increase in standard control services instead of direct control services as proposed by JEN.
154. JEN also notes that the position in the JEN preliminary decision is different from the preliminary decisions for the other Victorian DNSPs and those in other jurisdictions. JEN does not consider there is any basis for treating JEN differently in relation to these two pass through events and thus JEN considers that the preliminary decision does not promote an Optimal NEO Position. In particular, it would not promote efficient investment in, or operation or use, of the national electricity system or promote the long term interests of consumers were DNSPs in the same, or other jurisdictions, to be treated differently where they were equally impacted by the same event.
155. JEN therefore proposes that the term "standard control services" should be replaced with "direct control services" in the definitions for the natural disaster event and the terrorism event.