



Jemena Electricity Networks (Vic) Ltd

2021-26 Electricity Distribution Price Review Revised Regulatory Proposal

Attachment 08-01

Response to the AER's draft decision - Risk Management - Cost
pass-through



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Glossary

| | |
|---------------------------|---|
| current regulatory period | The regulatory control period covering 1 January 2016 to 31 December 2020 |
| draft decision | The draft decision on the determination that will apply to setting JEN's distribution prices for the next regulatory period |
| initial proposal | The initial regulatory proposal to the AER for the setting of regulated pricing for JEN for the next regulatory period |
| next regulatory period | The regulatory control period covering 1 July 2021 to 30 June 2026 |
| revised proposal | The revised regulatory proposal to the AER for the setting of regulated pricing for JEN for the next regulatory period |
| Amended EP Act | <i>Environment Protection Act 2017</i> (Vic) as amended by the <i>Environment Protection Amendment Act 2018</i> (Vic) |

Abbreviations

| | |
|-------|---------------------------------------|
| AER | Australian Energy Regulator |
| DNSP | Distribution Network Service Provider |
| EPA | Environment Protection Authority |
| JEN | Jemena Electricity Networks (Vic) Ltd |
| NER | National Electricity Rules |
| REFCL | Rapid Earth Fault Current Limiter |
| SAPN | SA Power Networks |

Overview

In Jemena Electricity Networks (Vic) Ltd's (**JEN**) 2021-26 initial regulatory proposal (**initial proposal**), we outlined our approach to managing risk and uncertainty.¹ We did this to demonstrate that we are a prudent business and to show that we take these matters very seriously—especially because of the high-risk exposure that JEN faces every day.

While risk management is a broad business activity, we placed a particular emphasis on the nominated cost pass-through events in our initial proposal. We did this because these events are a crucial feature of the regulatory regime that electricity distribution businesses operate under, and on which the Australian Energy Regulator (**AER**) must decide in making its determination for JEN for the 2021-26 regulatory control period (**next regulatory period**). Cost pass-through events are particular activities or events which, if they occur, entitle a Distribution Network Service Provider (**DNSP**) to apply the AER to recover the consequential costs incurred, or expected to be incurred, in managing the DNSP's response to the relevant event. The cost pass-through events that apply in a regulatory control period are:

- those events outlined in clause 6.6.1 of the National Electricity Rules (**NER**), and
- if nominated by the DNSP, any other events approved by the AER within the relevant price reset determination.

In our initial proposal, we sought to continue the nominated pass-through events that have applied to JEN for the 2016-20 regulatory control period (**current regulatory period**), subject to some modifications to address emerging risks.

In its 2021-26 electricity distribution price review draft decision (**draft decision**), the AER considered the pass-through events we nominated along with the conditions attached to them.

For the most part, we agree with the AER's draft decision findings. In this revised proposal for the next regulatory period (**revised proposal**), we:

- seek some relatively minor further refinements to clarify the intent of particular events, and
- propose an additional event, in response to an emerging area of risk, arising from the commencement of significant amendments to environment protection legislation in Victoria.

Customer impacts

What this means for our customers

- A clearly defined cost pass through framework improves customer understanding of how risk allocation operates, particularly in the case of those risks which are outside of JEN's control and therefore are appropriate to be the subject of a risk-sharing mechanism.
- The framework also creates greater confidence:
 - for investors – who can then invest with greater certainty, thereby maintaining the reliability of supply
 - insurers – who offer coverage knowing the regulatory framework supports a balanced risk environment and therefore can provide coverage at an efficient cost.

¹ JEN, *Attachment 07-08, Managing Risk and Uncertainty*, 31 January 2020.

- With our customers telling us affordability is essential to them, we need to find ways to effectively balance the sharing of risk and costs, especially for these low-frequency events. By sharing the risk for these low-frequency events with our customers, we can maintain a lower cost structure, thereby achieving a better cost outcome for customers.

JEN's response to the draft decision

The key decision items outlined in the AER's draft decision and our response to each of these are summarised in Table OV-1.

Table OV-1: Summary of the AER's draft decision on JEN's nominated cost pass-through events

| Nominated Pass-through event | AER position | JEN response |
|---|--|--|
| Insurance coverage event (replaces JEN's 'insurance cap event') | The AER has adopted the approach it took for defining an <i>insurance coverage event</i> in its recent determination for SA Power Networks (SAPN). The method largely continues the predecessor insurance cap event, however, now addresses gaps in insurance cover, as well as the insurance cap | Accept – we accept the AER's decision to implement an <i>insurance coverage event</i> . However, we consider that some minor drafting amendments will give greater clarity for Victorian electricity distribution businesses, and outline these in this document |
| Insurer credit risk event | The draft decision accepts our nominated pass through event without modification | Accept – no modifications |
| Natural disaster event | The draft decision accepts the intent of our natural disaster event, and outlines some amendments | Accept – with some drafting amendments outlined in this document |
| Terrorism event | The draft decision accepts our nominated pass through event without modification | Accept – no modifications |
| Retailer insolvency event | The draft decision accepts the intent of our proposed drafting and outlines some minor amendments | Accept – with one minor drafting amendment, as outlined in this document |
| Insurance premium event | The AER rejects our proposed insurance premium event | Accept – subject to their being no further change to the insurance premium operating expenditure step change, we will not pursue this cost pass through event |
| Environment protection event | N/A | This is a new event proposed in this revised proposal, in response to significant impending changes to Victorian environment protection laws. |

With the growing uncertainty brought about with the summer bushfires of 2019 / 20, the COVID-19 pandemic and a growing rate of change in legislative requirements, managing risk and uncertainty through the appropriate mix of management practices, insurance and the cost pass-through mechanism, is more important now than ever before.

We have assessed the effects of these major events that have occurred since submitting our initial proposal. We consider that a new environment protection event should be included as a nominated pass through event to address the high degree of uncertainty in transitioning to compliance with the new environment protection regime, particularly the new contaminated land management provisions.

Whilst it is possible to propose capital expenditure allowance to address these new environment protection legislative requirements, the degree of uncertainty as to potential impacts, and therefore costs is very high at present. Consequently, we consider that it is in the customers' long term interests to manage potential cost impacts arising from this new legislation through the cost pass through mechanism, rather than a capital expenditure allowance or a contingent project.

Aside from the environment protection event, we do not consider there is a need to nominate any additional pass-through events in this revised proposal.

We also propose some relatively minor wording changes to previously nominated events. In broad terms, these are intended to improve clarity and therefore go towards creating greater confidence in the application of the regulatory framework.

1. Insurance Coverage Event

In the current regulatory period, an insurance cap event has applied, in circumstances where an event occurs that requires JEN to incur costs in managing the event in excess of its insurances.

Noting recent changes in insurance markets, and difficulties utilities are currently encountering in securing an effective and efficient programme of insurances, we proposed:

- amendments to the insurance cap event, to reflect that issue may arise where there are gaps in insurance coverage due to unavailability of insurances in the current market, and
- a new event, the insurance premium event, which addresses the risk of significant increases in insurance premiums arising from events outside of our control.

In its draft decision, the AER did not accept our insurance premium event, but acknowledged the volatility in the current insurance liability market, through the inclusion of a new insurance coverage event, in place of the insurance cap event.

In response, we welcome the AER's decision to move to an insurance coverage event. This new approach to managing insurance risk recognises the complexity of the insurance market and the availability of coverage, particularly in the current environment when policies are tight.

We note that in proposing an insurance coverage event for the Victorian DNSPs, the AER has used the event drafting from the 2020-25 SAPN decision, with some minor additional modifications. We also welcome this change, recognising that greater uniformity in the approach across the National Electricity Market achieves a more consistent and therefore appropriate risk management framework. However, due to state-based nuances, we understand that some variation will still be required.

In response to an information request from the AER on insurance,² JEN considered the insurance coverage event outlined in the 2020-25 SAPN decision and recognised this could be a workable baseline on which to set an equivalent nominated pass through event in Victoria. We identified several modifications to the SAPN version of the event, and presented these to the AER in July 2020, in response to the information request. Details of that response, which includes explanations for the changes proposed at that time, is included in Appendix A (noting that we maintain our position on those changes, and therefore the explanations continue to be relevant).

We note that in the draft decision for JEN, the AER has not engaged on our modified insurance coverage event, instead deciding to consult on the modifications amongst all Victorian distribution businesses and relevant stakeholders through the draft decision consultation process, stating:

We have not considered Jemena's specific drafting changes as part of our draft decision for all the Victorian distribution businesses. Rather, we consider it more appropriate to first get feedback from all Victorian distributors in their revised proposals on our draft decision insurance coverage pass through event definition.³

JEN maintains that the position presented in our response to the AER's information request remains applicable. Following consultations with the other Victorian DNSPs, we have identified some further drafting improvements. These are set out in section 1.1 below.

1.1 Revised nominated pass through event

Note, amendments are shown as marked up against the version we submitted to the AER in August 2020, with commentary on those amendments in section 1.2.

² Information Request #48.

³ AER, *Draft Decision, Jemena Distribution Determination 2021 to 2026, Attachment 15 Pass through events*, September 2020, Pg. 15-13.

An insurance coverage event occurs if:

1. Jemena:

- 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. Jemena incurs costs:

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

3. The costs referred to in paragraph 2 above, either separately or in aggregate, materially increase the costs to Jemena in providing direct control services.

For the purposes of this insurance coverage event:

- 'base year' means the year used by the AER in the distribution determination as the base year to forecast operating expenditure in the 2021-26 regulatory control period.
- 'changed circumstances' means movements in the relevant insurance liability market since the acquisition of the insurance policy or set of insurance policies that applied during the majority of the base year that are beyond the reasonable control of Jemena, where those movements result in it no longer being possible for Jemena to take out with a reputable insurer:

- i) a 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.

- 'costs' means the amount that would have been recoverable 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 charged circumstances.
- '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).
- 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 Jemena was regulated.
- Jemena 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 Jemena in relation to any aspect of Jemena's network or business.

- Jemena 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 Jemena in relation to any aspect of Jemena'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:

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

1.2 Explanation of proposed amendments

For the explanation of changes to the insurance coverage event definition that were proposed by us prior to the draft decision being released, refer to Appendix A. Beyond that, only minor changes are proposed. These have arisen from our consultations with the other Victorian DNSPs, and comprise:

- clarification in paragraph 3 that the event permits the aggregation of cost impacts (for example, if insurance coverage comprised several layers, and two or more of those layers become unavailable, it is reasonable that the cost exposure can be aggregated should an incident arise that triggers, or would have triggered, the relevant insurance)
- drafting to recognise that the baseline position on our insurance programme is that which was in place in the base year – and that any changes / gaps arising relative to that position, provided those changes are beyond our reasonable control, would be considered to be changed circumstances
- clarification that in assessing an insurance coverage event, the content of any AER guidance will be a relevant consideration.

We understand that the other Victorian DNSPs are supportive of the revised wording Jemena proposes for this event.

2. Insurer credit risk event

We note that the draft decision states that it does not amend our proposed insurer credit risk event, however, in Table 15.2 of the draft decision, which outlines the pass through event definitions accepted in the draft decision, there are some very minor amendments to the definition of this event. We accept the AER's event as set out in Table 15.2 - for completeness it is restated below.

2.1 Restated nominated pass through event

An insurer credit risk event occurs if an insurer of Jemena becomes insolvent, and as a result, in respect of an existing or potential claim for a risk that was insured by the insolvent insurer, Jemena:

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

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

- i) 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, and
- ii) in the event that a claim would have been covered by the insolvent insurer's policy, whether Jemena had reasonable opportunity to insure the risk with a different provider.

3. Natural disaster event

A version of this event has applied throughout the current regulatory period. In our initial proposal, we sought an amendment to the event definition to include ‘unlawful’ before ‘acts or omissions’, to clarify that the event will still be operable if a natural disaster arises as a consequence of events, where Jemena is operating in full adherence to regulatory requirements.

In its draft decision, the AER recognised this particular issue, but expressed concern about the likely broadening of the scope of the event, should it accept our proposed amendment. The AER instead proposed other amendments to address the issue.

In principle, we accept the objective of the AER’s amended natural disaster event, however, we query whether the wording used in the draft decision properly addresses the issue (noting as drafted it may have some unintended consequences). Further proposed amendments are therefore set out in section 3.1 below, with commentary on those amendments in section 3.2.

3.1 Revised nominated pass through event

Note, amendments are shown as marked up against the event definition in Table 15.2 of the draft decision.

Natural disaster event means any natural disaster including but not limited to cyclone, fire, flood or earthquake that occurs during 2021-26 regulatory control period that increases the costs to Jemena in providing direct control services, provided the cyclone, fire, flood, earthquake or other event was not :

- (a) ~~a consequence of an Jemena’s acts or omissions (other than those that were was necessary for the service provider to comply with a regulatory obligation or requirement or with an applicable regulatory instrument); or~~
- (b) ~~not a consequence of any other act or omission of the service provider.~~

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

- (1) whether Jemena has insurance against the event; and
- (2) the level of insurance that an efficient and prudent DNSP would obtain in respect of the event.

3.2 Explanation of proposed amendments

On the basis of the event drafting set out in the draft decision, a natural disaster event would only be triggered where there is a natural disaster that is specifically a consequence of acts / omissions necessary for Jemena to comply with a regulatory obligation.

Recognising that natural disasters may legitimately occur that are totally unrelated to Jemena’s own acts or omissions, for which we should receive cost pass-through relief, we have therefore proposed revised wording to further clarify the issue, whilst keeping with the overall objective of the AER’s amendments.

Our proposed wording better clarifies that if a natural disaster occurs and we are meeting our regulatory obligations in full, we will satisfy the definition – but otherwise, if the event is a consequence of our acts or omissions we will not satisfy the definition and therefore cannot claim cost pass through relief.

In addition, we have proposed some minor clarification drafting to insert references to “cyclone” and “earthquake” in line 3, to align with the wording in line 1 of the event definition.

4. Terrorism event

We note that the draft decision does not amend our proposed insurer credit risk event. For completeness we restate the nominated event below.

4.1 Restated nominated pass through event

Terrorism event means an act (including, but not limited to, the use of force or violence or the threat of force or violence) of any person or group of persons (whether acting alone or on behalf of or in connection with any organisation or government), which:

- a) from its nature or context is done for, or in connection with, political, religious, ideological, ethnic or similar purposes or reasons (including the intention to influence or intimidate any government and / or put the public, or any section of the public, in fear), and
- b) increases the costs to Jemena of providing direct 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 an efficient and prudent DNSP 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.

5. Retailer insolvency event

A version of this event has applied throughout the current regulatory period. In our initial proposal, we proposed no change to the event, such that it would continue to apply in the upcoming regulatory period.

In its draft decision, the AER made some minor clarificatory amendments. We accept all of these.

We now propose one further amendment, which is shown in section 5.1 below as marked up against the wording from the event definition in Table 15.2 of the draft decision.

5.1 Revised nominated pass through event

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:

- 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
- b) other terms used in the definition of retailer insolvency event in the ~~NER 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).

For the purpose 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.

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.

5.2 Explanation of proposed amendments

We suggest one amendment to the definition as set out in the draft decision, in order to replace “Rules” with “NER”, to clarify that the definition of a retailer insolvency event is contained in the NER, not the National Energy Retail Rules.

6. Insurance Premium Event

In our initial proposal, we proposed an insurance premium event to create a mechanism for recovering operating expenditure attributed to increasing insurance premiums. These premiums have been—and are expected to continue—rising due to constraining insurance market conditions.

In the draft decision, the AER did not approve the addition of an insurance premium event, stating “we are not satisfied that it meets the nominated pass through considerations under the NER.”⁴ In the draft decision, the AER also:

- accepted an operating expenditure step change for insurance premium increases; *and*
- proposed an *Insurance Coverage Event* (in line with its recent SAPN decision).

6.1 Revised Position

Conditional on final decision:

- acceptance or non-material modifications to the *Insurance Coverage Event* relative to those identified in section 1; *and*
- approval of JEN’s operating expenditure step change for increased insurance premiums,

JEN proposes to withdraw the nominated insurance premium cost pass through event.

⁴ AER, *Draft Decision, Jemena Distribution Determination 2021 to 2026, Attachment 15 Pass through events*, September 2020, Pg. 15-15.

7. Environment protection event

7.1 Explanation of new event

Amendments made by the *Environment Protection Amendment Act 2018 (Vic)* to the *Environment Protection Act 2017 (Vic)* (**Amended EP Act**) commence operation on 1 July 2021. The Victorian Environment Protection Authority (**EPA**) is also expected to create new instruments under the Amended EP Act, which will be introduced in the short to medium term.

These legislative changes will impose significant new environment management obligations on JEN, over and above the obligations in place during the current regulatory period. The reforms implemented by the Amended EP Act relevantly include the introduction of:

- a general environmental duty, which requires those conducting an activity which poses risks to human health and the environment to take steps to understand those risks and minimise them so far as is reasonably practicable
- a duty to notify the EPA about contaminated land, where relevant contamination thresholds are exceeded, and
- a duty to manage contaminated land, by undertaking activities to minimise the risk of harm to human health and the environment so far as is reasonably practicable.

As noted in our initial proposal,⁵ we consider that the introduction of the general environmental duty and the specific obligations relating to land contamination are the main drivers of additional operational activities and expenditure for JEN, during the upcoming regulatory period.

Following the commencement of the Amended EP Act, JEN will also be required to test for historical contamination at sites which it owns or occupies and, where the applicable thresholds are assessed to have been exceeded, notify the EPA of impacted contaminated land sites, including details of JEN's proposed management activities at those sites. Steps must then be taken to manage the contamination issues identified, either as proposed or to meet directions or orders made by the EPA.

In our initial proposal, JEN:

- forecast operating expenditure in respect of contamination risk assessment, testing and monitoring activities, amounting to \$4.2M (\$2021) over the regulatory control period
- did not include any capital expenditure or operating expenditure forecasts relating to the remediation of contaminated sites, on the basis that it was not possible to accurately determine the nature and extent of such work, and therefore forecast the cost, until the above assessment and testing work has been completed. It is possible that the cost of contamination management activities, including remediation, could be significant (but until steps are taken to investigate below the ground at these sites, it is not really possible to formulate an estimate).

In its draft determination, the AER rejected our operating expenditure step change, stating that although the legislative changes introduced via the Amended EP Act represent a change to Jemena's regulatory obligations, the AER is not convinced that our proposed response is efficient,⁶ stating further:

We have examined the activities Jemena proposed to undertake and the associated cost estimates. We are concerned some of Jemena's assumptions regarding the proposed environmental risk assessment of zone substations and depots... are unrealistic... We do not consider such extensive testing is required...⁷

⁵ Attachment 06-05, operating expenditure step changes , page 19.

⁶ Refer draft determination, Attachment 6: Operating expenditure, page 6-68.

⁷ Ibid, page 6-69.

Given this outcome, and recognising the uncertain nature of these costs and the difficulty of preparing an accurate forecast, JEN now considers the risk is most appropriately addressed by via the cost pass through regime. We are therefore nominating a new cost pass through event, as set out in Table 7-1. We have also conducted an initial review of sites, to better scope the programme of investigation and works, as explained further below.

Table 7–1: Proposed environment protection event

| Event | Proposed definition |
|------------------------------|---|
| Environment protection event | <p><i>An environment protection event occurs when Jemena has prepared:</i></p> <ul style="list-style-type: none"> (a) <i>a compliance plan for meeting the requirements of the Amended EP Act, including any instrument made or issued under the Amended EPA or any direction, order or notice issued or decision made pursuant to the Amended EP Act or instrument made or issued under the Amended EP Act; and</i> (b) <i>a forecast of the capital and operating expenditure required to carry out the compliance plan.</i> <p><i>For the purposes of this environment protection event:</i></p> <p><i>‘Amended EP Act’ means the Environment Protection Act 2017 (Vic) as amended by the Environment Protection Amendment Act 2018 (Vic).</i></p> |

7.2 Further comments

We have taken the approach to define the event as being triggered by the preparation of a plan of works and a cost forecast, which are assessed as being required to ensure compliance with the Amended EP Act requirements. This is similar to the approach adopted by the AER for the Rapid Earth Fault Current Limiter (REFCL) contingent projects in Victoria in the current regulatory period⁸. For those projects there was considerable uncertainty as to the costs that would be required to comply with the then draft regulations, such that it was not appropriate to include capital expenditure forecasts for required works in the building block proposals.

Whilst there are some parallels to the contingent project process that provide a useful source of guidance in drafting of the event itself, there are also some differences between the present case and the REFCL projects, such that cost pass through should be preferred here over contingent projects as the most appropriate mechanism for cost recovery and risk sharing.

In the case of the REFCL contingent projects, there was a high degree of certainty around the nature and extent of the cost at the time of lodging a regulatory proposal ahead of the current regulatory period, and therefore, to meet the contingent project criteria as set out in clause 6.6A.1(b) of the NER. It was clear at the time that the most appropriate avenue in that case for regulatory cost recovery was a contingent project.

In the present circumstance, the amount of operating expenditure and capital expenditure required to meet the Amended EP Act obligations—at the time of making this submission—is highly unknown (and will remain as such until the initial phase of investigations proceeds, which will provide us with the information on what is below the surface of impacted sites, and from there allow for works to be scoped and cost to be forecast). For this reason, it is not possible to consider a contingent project option for recovering any necessary costs, and a nominated cost pass through event is the most appropriate mechanism for *materially*⁹ high costs.

We consider that the inclusion of the environment protection event is supported by reference to the nominated pass-through event considerations, as explained in Table 7–2.¹⁰

⁸ These are projects being implemented by Powercor Australia Ltd and Ausnet Services (electricity distribution).

⁹ NER, Chapter 10, see definition of *materially*.

¹⁰ NER, cl 6.5.10(b).

Table 7–2: Assessment of nominated pass through event considerations in respect of the environment protection event

| Criteria | Explanation |
|--|---|
| <p>Whether the nominated pass through event is an event already covered in the NER</p> | <p>The cost pass-through events as outlined in the NER are (i) a regulatory change event, (ii) a service standard event, (iii) a tax change event, and (iv) a retailer insolvency event.¹¹</p> <p>The circumstances intended to be captured by this environment protection event would not fall within the definitions of each of events (ii), (iii) and (iv).</p> <p>It may be possible to argue that the regulatory change event might be triggered (depending on the factual circumstances), but there are also some arguments to the contrary, noting:</p> <ul style="list-style-type: none"> • the Amended EP Act was passed by the Victorian Parliament well prior to the commencement of the upcoming regulatory period - therefore raising an issue as to the applicability of para (b) of the regulatory change event definition (i.e. is the change in the obligation measured as at the date the legislation passes through Parliament, or when it comes into force, noting in the present case the commencement has been substantially delayed). Related to this issue is the fact that various subordinate instruments under or contemplated by the Amended EP Act, which could impact JEN's response to this new law, have yet to be finalised), and • arguably, it is not the commencement of the Amended EP Act (or subordinate instruments) that could result in the significant expenditure – rather it is the subsequent discovery of significant contamination that is the key trigger point in terms of requiring activities that incur cost. <p>Given these issues, we consider certainty and clarity here is best promoted by a stand-alone environment protection event.</p> |
| <p>Whether the nature or type of event can be clearly identified at the time the determination is made</p> | <p>The nature and type of environment protection event can be clearly identified at the time of the AER's determination. It effectively requires the following to occur:</p> <ul style="list-style-type: none"> • commencement of the Amended EP Act (as defined in the event) and relevant subordinate instruments • an assessment of the contamination status of JEN's sites (includes on site inspection and soil and groundwater sampling activities) • preparation of a plan which sets out the works and other management activities required for applicable JEN sites to comply with the new legislation and instruments, and • preparation of a forecast of the cost, comprising assessments, works and other activities, all required for compliance purposes. |
| <p>Whether the event could be avoided or substantially mitigate the cost impact.</p> | <p>These requirements are not optional and must be performed. JEN has already undertaken an initial review and risk assessment of the sites it occupies, with a view to targeting a smaller number of particular sites for further assessment work (as part of the compliance plan) – rather than conducting these assessments right across the JEN property portfolio. This initial review has involved:</p> <ul style="list-style-type: none"> • a desktop review of existing site records • surveys of site management staff, seeking further information about potentially contaminating activities that may have occurred on JEN sites, either at present or in the past • assessment of results against a set of criteria, to determine a short list of 'high risk' locations. |

¹¹ NER cl. 6.6.1(a1)(1)-(4).

| Criteria | Explanation |
|---|--|
| | The primary purpose of this initial review is to reduce the number of JEN sites to be the subject of further assessment (and, if required, works). These assessments are not sufficient on their own to provide enough certainty to consider the case for a contingent project, or otherwise to enable works plans and cost forecasts to be prepared. |
| Whether the event can be insured, having regard to insurance and self-insurance | Insurance not an option in this case. |
| Any other matter the AER considers relevant. | These Amended EP Act requirements are new and go above and beyond the environmental laws that applied to JEN during the current regulatory period and previously. There still remains a high level of uncertainty as to the nature and extent of activities required to address the Amended EP Act requirements. In light of these considerations, it is appropriate to address any potential consequences via cost pass through, rather than via JEN's capital expenditure and operating expenditure forecasts. |

Appendix A

Insurance coverage event drafting changes and discussion notes

A1. An explanation for drafting changes

Below we outline the mark-ups and reasoning for the insurance coverage event drafting changes submitted to the AER in July 2020, in response to an information request.

To readily identify the changes in drafting across the initial proposal, draft decision and revised proposal we have adopted some formatting codes, there are:

- Underlined text represents additions proposed relative to the SAPN version
- Strike-through text represents deletions relative to the SAPN version
- Red text represent our additional proposed amendments in this response
- Grey highlighted text are notes supporting the amendments

A2. Insurance coverage event with marked-up changes

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

[Drafting 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

[Drafting Note: we consider "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, **either separately or in aggregate**, materially increase the costs to JEN in providing direct control services.

For the purposes of this insurance coverage event:

- 'base year' means the year used by the AER in the distribution determination as the base year to forecast operating expenditure in the 2021-26 regulatory control period.
- 'changed circumstances' means movements in the relevant insurance liability market **since the acquisition of the insurance policy or set of insurance policies that applied during the majority of the base year** 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.~~

[Drafting 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 charged circumstances.

[Drafting 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).

[Drafting 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;
- **Any guidance published by the AER on matters the AER will likely have regard to in assessing any insurance coverage event that occurs;** and
- Any information provided by JEN to the AER about JEN's actions and processes.