Jemena Electricity Networks (Vic) Ltd

2021-26 Electricity Distribution Price Review Regulatory Proposal

Appendix 07-08

Managing risk and uncertainty

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Abbreviations

AER	Australian Energy Regulator
AON	Aon Risk Services
DNSP	Distribution Network Service Provider
JEN	Jemena Electricity Networks (Vic) Ltd
JCARS	Jemena Compliance and Risk System
HBRA	High Bushfire Risk Area
NER	National Electricity Rules
NEM	National Electricity Market
SAPN	SA Power Networks

Overview

Jemena Electricity Network's risk management framework

In preparing our regulatory submission, we are required to forecast our costs and the revenue we will need over the five-year regulatory period to recover them. It is not an exact science, as there are many external factors—such as natural disasters, shifts in Government policy or changes in the operation of the energy market—that are difficult to predict, yet could significantly impact our customers, and our business, during that time.

We identify material risks that cannot be fully mitigated or prevented through internal controls, or where commercial or self-insurance may not be available on a reasonable basis, using a Risk Management Framework. Our Risk Management Framework is described in section 1. We note that it has not materially changed from the framework presented in our previous regulatory proposal.[1]

Rationale for cost pass through

For certain types of risks which arise in operating our business, it may be more efficient to "pass through" cost changes via the cost pass through mechanism under the NER. This mechanism provides additional (or reduced) funding, subject to AER approval, to cover any significant increases (or decreases) in costs as a result of a pre-defined event.

We consider that managing our exposure via the pass through provisions is the most prudent and efficient means for addressing uncontrollable, low probability, but high cost impact events. In doing so, we ensure that our forecast operating expenditure and capital expenditure does not include any large or speculative allowances for events that may not happen. In turn, this keeps the focus on affordability, as it is in our customers' best interests to only pay what is necessary for us to deliver effective and efficient network services.

Our nominated cost pass through events

The NER already specifies four cost pass through events relating to changes in regulations, service standards or taxes and the insolvency of a retailer.[2] The NER also enables Jemena Electricity Networks (Vic) Ltd (**JEN**) to nominate additional pass through events having regard to the nominated pass through event considerations.[3]

After reviewing our risk management processes and systems, we have proposed the following nominated pass through events to apply in the next regulatory period:

- Existing nominated pass-through events that applied in the current regulatory period—the "insurer credit risk event", "natural disaster event", "terrorism event, and Victorian-specific "retailer insolvency event" are to continue to apply. We have made minor changes to the natural disaster event. These changes are discussed in section 2.

- New or amended nominated pass-through events—In response to recent issues concerning the availability and costs of procuring bushfire liability insurance, we propose to amend the "insurance cap event" and add a new additional pass through event, referred to as the "insurance premium event". This is discussed in section 2.2.

[1] JEN, *2016-20 EDPR Regulatory Proposal, Attachment 5-4 – Risk Management Framework*, 30 April 2015.

[2] As the National Energy Customer Framework (**NECF**) has not been adopted in Victoria, the retailer insolvency event in clause 6.6.1(a1)(4) of the NER does not currently apply to the Victorian DNSPs.

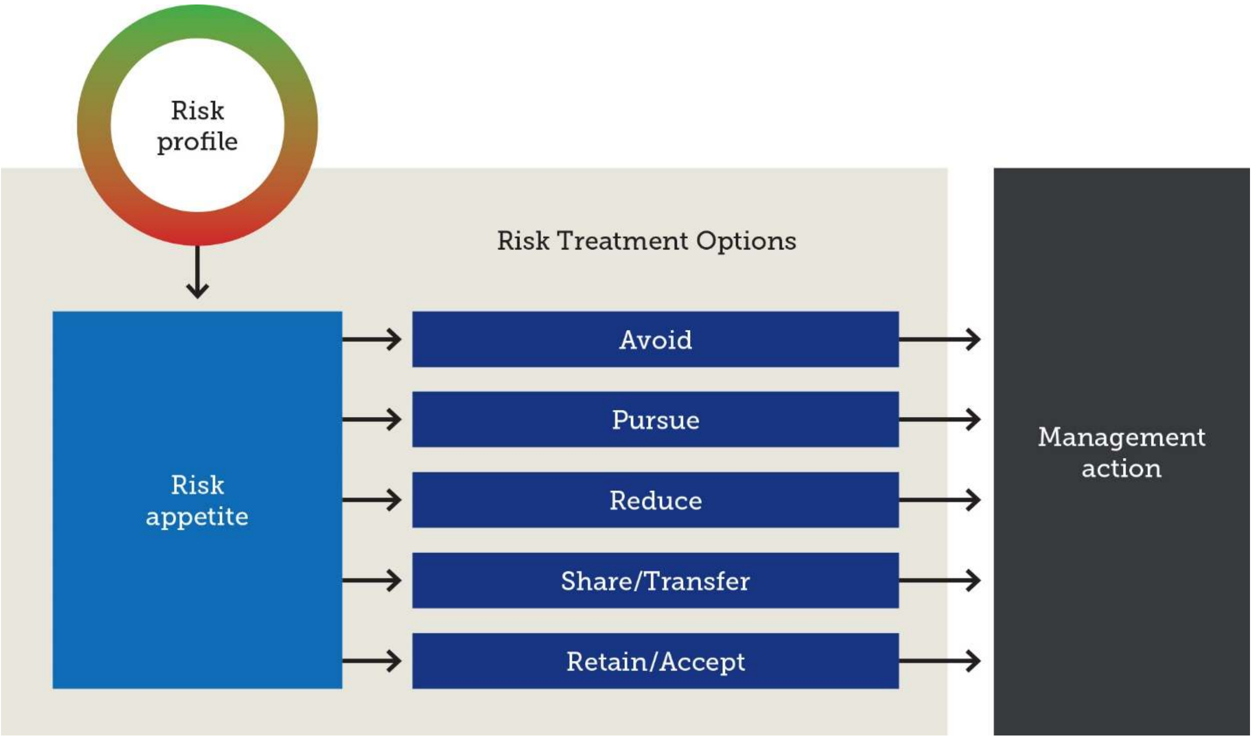
[3] NER, cl 6.5.10.

1. Risk Management Framework

1.1 Options for managing risk

Most businesses, including ours, will seek to manage risk in one of five ways, as set out in Figure 1–1.

Figure 1–1: Risk treatment options matrix



We will, generally:

- **Avoid** risks that are very likely to occur and would be particularly damaging to the business—for example, we avoid any activity we consider to be an unacceptable health and safety risk to our employees, customers and the community.
- **Pursue** risks where the nature and extent of the changes required to achieve desired performance do not exceed our management's tolerance for risk—for example; we may introduce new technologies to enhance the reliability of the network
- **Reduce** risks where we consider there is a relatively high chance of an event occurring, but we can mitigate against its impact at a relatively low cost—for example, we mitigate the impact of storm events through our vegetation-management programs and emergency response management plans.
- **Transfer** risks that are relatively unlikely to occur and would be particularly damaging to the business if they did eventuate—for example, we may take out liability insurance to transfer a risk to customers or the community that we are unable to mitigate or avoid fully.
- **Accept** risks that have a reasonably low probability of occurring and would have a low impact to customers, the community or a low cost to our organisation.

How we manage a particular risk depends upon the options available, and how efficient and effective they are based on our risk tolerance. Our decision-making process is founded in our corporate risk management framework and associated policies. We look to the framework and policy to guide us in choosing the most efficient and effective way to manage risks.

Occasionally, we have to share risk with customers, in what is known as a pass-through event. Our customers expect us to minimise, to the extent possible, the likelihood of risks being transferred to them, so this is an approach that we look to avoid as much as possible.

1.2 Our approach to risk management

1.2.1 Risk management framework

Our risk management framework consists of an integrated package of corporate and asset-specific risk management policies, plans, and procedures. We are committed to ensuring that risk management is embedded in the business' operations and culture by incorporating risk management as part of every business process, on the basis that:

- it is everyone's responsibility to manage risk
- our business as a whole owns risks
- risk management is embedded in normal business processes
- risk management provides early warning, and that enables us to mitigate the impacts
- considering risks through both a top-down and bottom-up approach.

Our approach is underpinned by the following key risk management principles that are set out in ISO 31000:2018. The standard says risk management is:

- integrated—an integral part of all organisational activities
- structured and comprehensive—which contributes to consistent and comparable results
- customised and proportionate to the level of risk faced by the organisation
- inclusive—stakeholders are consulted in a timely fashion to allow their knowledge, views and perceptions to be considered
- dynamic—it anticipates, detects, acknowledges and responds to changes and events in an appropriate and timely manner
- based on the best information available
- influenced by human and cultural factors
- continually improved through learning.

1.2.2 Risk management policy

Our risk management policy ensures we take a strategic and systematic approach to balancing the need to meet business objectives with the need to assess and manage risk effectively.

The policy and the approaches adopted are also consistent with best-practice principles and the Australian risk management standard, ISO 31000:2018. The policy is designed to protect:

- our employees and customers
- the environment in which we operate
- our position as a provider of quality products and services.

The policy explicitly recognises that the business must take some risks in undertaking its core functions and pursuing opportunities. The risk profile we have adopted is balanced against the potential rewards from taking risks.

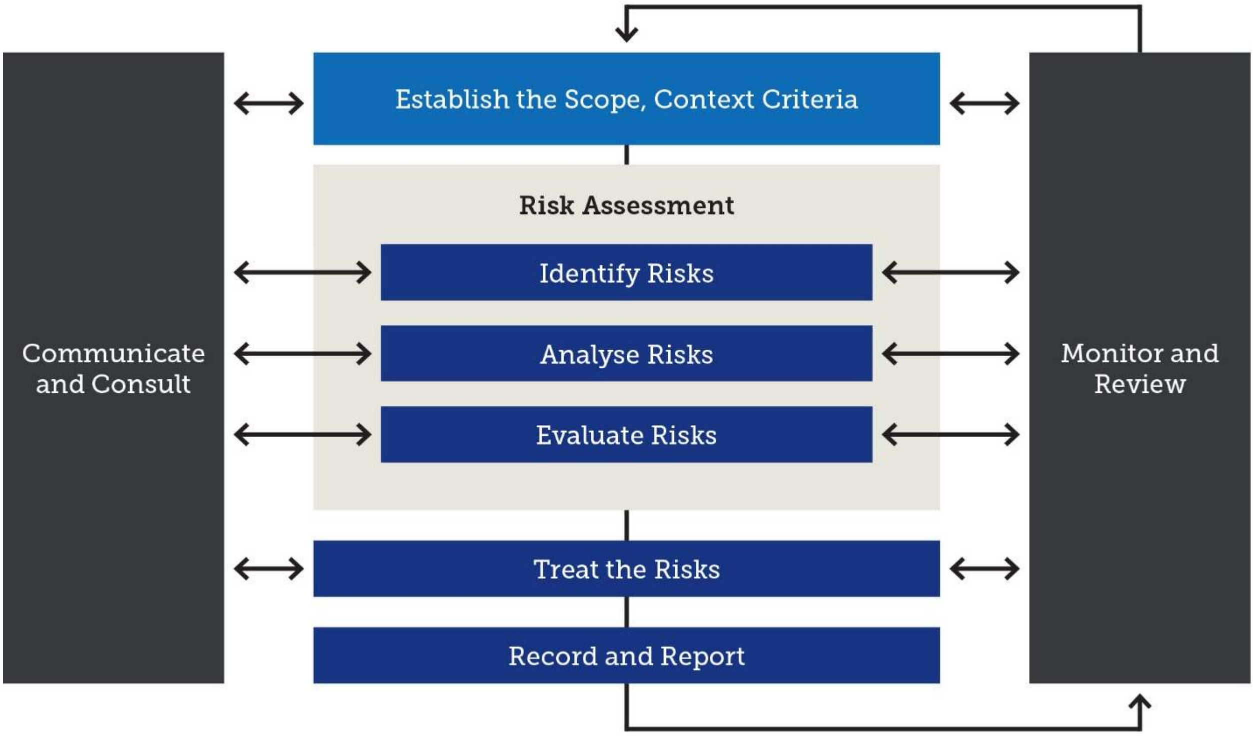
The Jemena risk management manual is a dynamic document that is designed to ensure the policy is implemented, and risk management is embedded in our practices and processes. Together, they formalise and set out our risk management framework. The framework is also supported in our organisation by following policies and procedures, which cover a range of subject areas including asset management, customer, health & safety, finance, information security and procurement.

Our risk management manual contains a risk/consequence matrix which reflects our attitude for risk. The parameters for a consequence are based on a five-point scale that ranges from minor to catastrophic. The consequences vary, depending on the nature of each risk, and their rating is determined by our capacity and appetite for risk, as well as our organisational objectives.

1.2.3 Risk management process

Risk management is ultimately achieved through our risk management process, set out in Figure 1–2:

Figure 1–2: JEN's risk management process



Risk management at Jemena is an iterative process, in which internal risk facilitators support the relevant risk owners to ensure that the key risk management activities are implemented, reviewed and re-assessed at a reasonable and appropriate frequency. The risk management process involves:

- establishing the context
- assessing the risk by defining it correctly and identifying its causes
- analysing the likelihood and potential consequences of the risk, as well as the impact of not treating it. This approach also includes an assessment of the controls in place, identifying mitigation actions and other potential controls, assessing the overall effectiveness of control and assessing the residual risks
- evaluating the risk including priority, escalation level and reporting requirements
- treating the risk through a series of risk treatment options
- recording and documenting the risk and its responses through the risk management system and appropriate mechanisms.

Communication is key to our risk management process. As part of our preparation for this regulatory determination process, and using our risk management framework, we engaged relevant areas of JEN’s business to identify and assess the nature of risks relating to JEN in the next regulatory period. This enabled us to assess the risks which will carryover from the current period, and also identify changed circumstances which giving rise to new risks. Through this process we could then determine the appropriate treatment of the risks, which, as described above, may include proposing a cost pass through event for risks which are uncontrollable, uninsurable and material to JEN’s costs of operating its network.

2. Continuance of current nominated pass-through events

In accordance with our risk assessment process discussed in section 1, JEN has assessed the major risks which were taken into account in the nominated pass through events approved in our current regulatory period,[4] relating to insurer credit risk, natural disasters, terrorism acts and retailer insolvency.

We consider that, in respect of each of these events there has been no change in circumstances which alters the rationale for including these as nominated pass through events into the next regulatory period – that is, they are events which:

- are uncontrollable and have a low probability of occurrence
- cannot be effectively insured against, in that commercial insurance is not available on cost-effective or reasonable terms
- would result in significant costs for JEN
- are not otherwise accounted for in our regulatory proposal and fall outside the prescribed pass through events in the NER.

The inclusion of these events is supported by the nominated pass through event considerations as well as recent AER decisions.[5]

Table 2–1: Assessment of nominated pass through event considerations in respect of insurer credit risk, natural disaster, terrorism acts and retailer insolvency

Criteria	Explanation
Whether the nominated insurance event is an event already covered in the NER.	The current nominated pass through events relating to insurer credit risk, natural disasters, terrorism acts and retailer insolvency are not already covered by any categories of pass through events specified in the NER.
Whether the nature or type of event can be clearly identified at the time the determination is made.	Each of the events can be and are clearly identified.
Whether the event could be avoided or substantially mitigate the cost impact.	JEN cannot prevent a natural disaster, terrorist event, retailer insolvency or insurer credit risk event. The occurrence and magnitude of the events are beyond the control of JEN.
Whether the event can be insured, having regard to insurance and self-insurance.	JEN cannot obtain appropriate insurances on reasonable commercial terms to cover the full range of costs that could be potentially incurred as a result of the occurrence of these specific events.
Any other matter the AER considers relevant.	The AER has approved these events for JEN's current regulatory period, as well as for other network businesses.

In light of the above, we nominate the pass through events approved by the AER as part of the 2016-20 regulatory period (subject to the minor amendment to the natural disaster event discussed in section 2.1) to apply in the next regulatory period. These events are set out in 2.2 below.

4 AER, *Final decision Jemena distribution determination, Attachment 15 - Pass through events*, May 2016.

5 For example, see AER, SA Power Networks 2020-25 Draft decision, *Attachment 14 – Pass through events*, October 2019. AER, Ausgrid 2019-24 Draft Decision, *Attachment 14 – Pass through events,* November 2018.

2.1 Minor change to "natural disaster event"

We have only made a minor change to the natural disaster event to include the word "unlawful" before "acts or omissions" for the same reasons set out in SA PowerNetworks (**SAPN**) recent revised proposal in its 2020-25 regulatory process.[6]

Specifically, the natural disaster event carves out from its scope any natural disaster event which is a consequence of the acts or omissions of the service provider. As proposed by SAPN, we have included the word "unlawful" to preserve the availability of the event, if a natural disaster (such as fire) arises as a consequence of JEN acting (or not acting) in adherence to its regulatory requirements.

An example of where the current wording of the natural disaster event may give rise to an unintended result is set out below.

Rationale for including the word "unlawful" in the "natural disaster event"

Similar to SAPN, JEN is subject to prescriptive regulations around the extent of vegetation that is required to be cleared, including:

- placing restrictions on JEN from cutting trees any more than is necessary to meet the minimum clearance requirements for certain native or other protected trees[7]
- requiring JEN to not undertake cutting until notification and consultation procedures with certain affected persons is undertaken, which may delay or result in an altered approach to cutting.[8]

The availability of the natural disaster event should not be precluded if, for example, JEN complies with its obligations with respect to cutting vegetation, and following this, the relevant vegetation subject of its clearance obligations comes into contact with its distribution infrastructure. That is, it is not the intended application of the natural disaster event that JEN's lawful act or omission (for example, to cut the tree in a certain way as a result of required consultation processes or to not cut the tree beyond a certain length because it is protected) should preclude the event's availability. The inclusion of the word "unlawful" before the words act and omission removes this unintended result.

2.2 Nominated pass through events

Table 2–2 below sets out the nominated pass through events which we propose to continue to apply into the next regulatory period.

Table 2–2: Current nominated pass-through events to continue to apply in the next regulatory period

#	Event	Proposed definition
1	Insurer credit risk event	An insurer credit risk event occurs if an insurer of JEN 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, JEN: 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) 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

6 SA PowerNetworks, 2020-25 Revised Regulatory Proposal, *Attachment 13 – Pass through events*, 10 December 2019.

7 *Electricity Safety (Electric Line Clearance) Regulations 2015* (Vic), Schedule 1 Code of Practice clause of Part 1. See also clause 11.

8 Ibid, Division 3 of Part 2, clause 17.

#	Event	Proposed definition
		ii) in the event that a claim would have been made after the insurance provider became insolvent, whether JEN had reasonable opportunity to insure the risk with a different provider.
2	Natural disaster event	Natural disaster event means any natural disaster including but not limited to fire, flood or earthquake that occurs during 2021-26 regulatory control period that increases the costs to JEN in providing direct control services, provided the fire, flood, earthquake or other event was not a consequence of JEN's unlawful acts or omissions. Note: In assessing a natural disaster event pass-through application, the AER will have regard to, amongst other things: c) whether JEN has insurance against the event; and d) the level of insurance that an efficient and prudent service provider would obtain in respect of the event.[9]
3	Terrorism 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: e) 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 f) increases the costs to JEN 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 JEN has insurance against the event ii) the level of insurance an efficient and prudent service provider would obtain in respect of the event, and iii) whether a relevant government authority has made a declaration that a terrorism event has occurred.
4	Retailer insolvency 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: g) 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 h) other terms used in the definition of retailer insolvency event in the Rules as a consequence of amendments made to that definition from time to time, which would otherwise take their meaning by reference to provisions of the NER or National Energy Retail Law not in force in Victoria, take their ordinary meaning and natural meaning, or their technical meaning (as the case may be).

9 We note that in the AER's recent SAPN 2020-25 draft decision it determined to include an additional factor for the AER to take into account relating to government authority declaration of a natural disaster event. In our 2016-20 price determination process, the AER proposed this initially, but ultimately considered it unnecessary to include as a factor (See AER, Final Decision Jemena distribution determination 2016 to 2020, *Attachment 15 – Pass Through Events*, May 2016 p 16). For the same reasons we proposed then, we consider that it is not appropriate to include this as a factor (See, JEN, 2016-20 Electricity Distribution Price Review Regulatory Proposal, Attachment 4-1 Risk Management Framework, Jan 2016, section 3.3.4). Nothing has occurred since the last review process to provide cause to change the existing drafting.

#	Event	Proposed definition
		For the purposes of this definition, the terms 'eligible pass-through amount' and 'positive change event' where they appear in the NER are modified in respect of this retailer insolvency event in the same manner as those terms are modified in respect of the retailer insolvency event prescribed in the NER from time to time. 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.

3. Cost pass through events to address issues in the liability insurance market

3.1 Overview

In this section we propose to:

- amend the “insurance cap event”, to better reflect the approach JEN and other networks undertakes to procure an entire program of liability insurance cover, and the difficulties encountered in securing an effective and efficient program of insurance in current and expected market conditions
- introduce a new nominated pass through event, the “insurance premium event”, which addresses the risk of significant increases in insurance premiums arising from events outside of JEN’s control.

In support of these updates, we first provide an explanation of JEN’s liability insurance program and the current market conditions contributing to reductions in insurance capacity and increases in costs.

3.2 JEN’s liability insurance program structure

JEN, like other electricity distribution network service providers (**DNSPs**), procures a general liability insurance program.[10] General liability insurance is the key insurance policy which responds to claims made against JEN seeking compensation for loss, injury or property damage to customers or the community. Policy coverage includes major events, such as bushfire, and is essential to mitigate JEN’s business operational risk exposure. JEN is covered under the SGSPAA Group general liability policy up to an indemnity limit of [redacted].

The SGSPAA Group general liability insurance program is extremely complex in nature involving [redacted]. As demonstrated in [redacted] the total policy cover limit is comprised of layered bands of insurance cover [redacted] relating to specified amounts of insured risk. These layers sit between the overall level of deductible and maximum claim limit. Each band will have a lower and upper limit defined by the amount of loss covered [redacted] Within each band, there are a number of different insurers who contribute to a specified portion of risk.

10 [redacted]

[redacted]

[redacted]

The complex arrangements for general liability insurance placement reflects the fact that no single insurer is prepared to or financially capable of providing insurance up to the total policy limit, or even across an entire band of risk. Each of these insurer contributions are renewed annually attracting different terms and conditions and requiring months of negotiation.

3.3 Trends in the insurance liability market impacting availability and cost of insurance

The global liability insurance market which underwrites DNSPs, such as JEN, with bushfire risk is characterised by two key features – limited capacity and high degrees of volatility. In particular:

- The number of global insurers who cover bush fire risk is restricted, with only a finite amount of insurance capacity to support the general liability insurance programs of Australian and international electricity network businesses. This means that JEN has to compete against other government and privately-owned network businesses on a world-wide basis to procure from this limited (and as discussed below, reducing) pool of insurance capacity.
- In addition to being finite, the global insurance market is also extremely volatile, with insurers' capacity and participation in the market rapidly influenced by the claims environment (such as recent major bushfires and class-action claims and settlements arising from those events both domestically in Australia and in the international market). With significant increases in insured losses due to major bushfire and wildfire events, insurers will seek to remediate their portfolios and minimise aggregate exposure over all clients with exposure to bushfire risk.

Having regard to the above market features, the bushfire liability market faced by JEN and other network businesses has, and continues to, contract and deteriorate, as a result of catastrophic insured losses from recent bushfire events including the wildfires in California in 2017 and 2018, as well as more locally, the Victorian St Patrick's Day bushfires.

Particularly over the last 12 months, the market has responded to the severity of recent claims by reducing capacity or withdrawing completely from offering bushfire risk insurance. This contraction of the market has coincided with significant increases in associated premiums.[11] Our insurance broker Aon Risk Services (**Aon**) notes that:

[11] Confidential Attachment 06-06, *Insurance Premium Forecast*.

[redacted][12]

The adverse effects of the contracting insurance market were felt in the process of renewing JEN's 2019/20 general liability insurance program. In particular:

- [redacted] of [redacted] insurers which constituted the Group's liability insurance placements in the previous year withdrew from writing bushfire liability. [redacted]
- The liability premiums increased significantly across the SGSPAA group, by approximately [redacted]% from the prior year. [redacted].[13]

We note that JEN is not alone – and that other DNSPs have incurred significant challenges in obtaining sufficient general liability insurance under current market conditions. For example, SAPN, in its revised proposal to the AER, notes that it has been advised that market conditions will:

> "…worsen during the 2020-25 regulatory control period as the available capacity in the international insurance market continues to tighten and increasing severity and frequency of extreme weather events results in larger and more frequent levels of insurance claims".[14]

Our experience during the procurement process for the 2019/20 bushfire liability insurance program has raised two key risks for JEN, which, if they occur, will give rise to material costs in future periods. In particular:

- First, there exists the risk that gaps may arise within layers of insurance cover located above the overall deductible and below the maximum cover limit. Specifically, the reduction in the number of market participants and capacity to offer bushfire liability insurance may mean that, in future renewal negotiations, JEN is unable to procure complete coverage or "plug the gaps" within its insurance program.
- Second, and related to the first point, further contraction of the insurance market will inevitably result in greater premiums in the future. [redacted][15]

To address the above two risks, we have proposed:

- changes to the "insurance cap event" to clarify that it will include costs associated with events which cannot be insured because there are gaps *within* the insurance policy program (rather than just limited to costs incurring *above* the overall cap limit)
- a new "insurance premium event" which relates to the potential cost increases in annual premiums charged by insurers to secure a sufficient portfolio of insurance coverage.

Further details explaining these nominated events, as well as an assessment against the nominated pass through event considerations is set out in sections 3.4.2 and 3.5.

12 Confidential Attachment 06-06, *Insurance Premium Forecast*.

13 Ibid. [redacted]

14 SA PowerNetworks, *2020-25 Revised Regulatory Proposal*, *Attachment 13 – Pass through events*, 10 December 2019

15 The drivers of these expected cost changes, and there allocation to JEN, is explained in more detail in Attachments 06-05 and 06-06 of this Regulatory proposal.

3.4 Modified insurance cap event

3.4.1 Explanation of drafting amendments to insurance cap event

In our view, the current wording of the insurance cap event, reflects a simplification of the insurance coverage procured by DNSPs and was based on historical insurance procurement in a soft market with abundant capacity available. It does not reflect the current insurance market position or the anticipated continued hardening of the insurance market. In particular, the wording assumes that a DNSP obtains coverage up until a cap total from a single policy. This is indicated by the words "…JEN incurring costs *beyond* the policy limit" referring to the singular. However, as discussed above, DNSPs such as JEN do not have a single insurance provider who can write the entire program of liability.

The current form of the insurance cap event does not clearly extend to cover the potential gaps that might arise *within* the insurance policy program structure, which comprises layered insurance policies between the overall deductible and maximum cap limit, involving several participants contributing difference percentages of risk within those different layers.

As a result of current market conditions, coverage across a certain band (for example, the middle layers of risk) may not be able to secured, even though coverage may be achieved in other layers (e.g. higher, less probable, layers of risk which attract smaller insurance premiums).

In response to the above, we propose to modify the existing insurance cap event to address the risk of gaps in insurance cover that may arise in future periods for which it is not economic to procure or self-insure against, and which arise as a result of market conditions that JEN cannot mitigate or control.

The basis for each of our drafting changes to the existing event is explained below:

- *Multiple insurance policies* – We have amended the drafting of the definition to reflect the layered composition of public liability insurance cover. No single insurance provider will insure against such risk. Accordingly, we have included the words "program of insurance policies" to reflect actual arrangements for insurance cover.
- *Outside of the range of cover* – We have also added the words "which otherwise fall outside the range of cover provided under the policy or program of policies" to make clear that this event will be triggered if costs are not covered because *either* the costs are above the overall policy limit or are not captured between or within a band of liability.

  As noted above, the insurance cover provided under a program of insurance policies takes into account the level of the deductible (or excess) and the minimum and maximum cover amounts of each layered insurance policy up to an overall limit. Under a layered program of insurance cover, costs may be uninsured because policy gaps were unable to be filled on reasonable terms between or within the insurance policy layers. For example, costs attributed to an insurable event may be outside the minimum and maximum cover of one insurance policy layer, and then are not covered by the next policy layer.

The above changes to the insurance cap event are set out in Table 2–2Table 3–1 below.

Table 3–1: Insurance cap event to address coverage issues

Event	Proposed definition
Insurance cap event	An insurance cap event occurs if: a) JEN makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy <u>or program of insurance policies</u>; b) JEN incurs costs beyond the policy limit or <u>otherwise which fall outside the range of cover provided under the relevant</u> <u>insurance</u> policy <u>or program of policies</u>; and c) the costs beyond the policy limit <u>or otherwise outside the range of cover provided under the relevant insurance policy or policies</u> increase the costs to JEN in providing direct control services.

Event	Proposed definition
	For this Insurance Cap Event: d) a relevant insurance policy is an insurance policy held during the 2021-26 regulatory control period or a previous regulatory control period in which JEN was regulated; e) the range of cover under a program of policies takes into account the bands of liability for which JEN is insured, and within those bands, the minimum and maximum cover amounts of each insurance policy; f) JEN will be deemed to have made a claim on a relevant insurance policy if the claim is made by a related party of JEN in relation to any aspect of the Network or JEN's business. Note in making a determination on an Insurance Cap Event, the AER will have regard to, amongst other things: i) the insurance policy or policies for the event ii) the level and range of insurance cover that an efficient and prudent NSP would obtain in respect of the event, and iii) any assessment by the AER of JEN's insurance in making its distribution determination for the relevant period.

3.4.2 Nominated pass through event considerations assessment

We have set out in Table 3–2 our assessment as to how the nominated pass through event considerations are satisfied by the proposed amendments to the insurance cap event definition.

Table 3–2: Assessment of nominated pass through event considerations in respect of insurance cap event

Criteria	Explanation
Whether the nominated insurance event is an event already covered in the NER.	The cost pass-through events as outlined in the NER include (i) a regulatory change event, (ii) a service standard event, (iii) a tax change event, and (iv) a retailer insolvency event. [16] An insurance premium event would not fall within the definitions of any of these events.
Whether the nature or type of event can be clearly identified at the time the determination is made.	The nature and type of insurance cap event can be clearly identified at the time of the AER's determination (as was the case for the version of the insurance cap event determined by the AER in its 2016-20 decision for JEN).
Whether the event could be avoided or substantially mitigate the cost impact.	The insurance liability market is contracting as a result of withdrawals of and reductions in capacity from global insurers as a consequence of recent catastrophic events and insured losses. This is resulting in the unavailability of certain levels of insurance cover, or the availability of those levels of cover but at prices that are not commensurate with the accepted risks. A prudent and efficient network service provider cannot reasonably prevent either of the above events from occurring, nor can it substantially mitigate the cost impact of such events. In particular because, the contraction of the market coincides with events outside of JEN's control including claims activities in Australian and globally.
Whether the event can be insured, having regard to insurance and self-insurance.	The event addresses costs arising because external insurance was unable to be obtained or was not available on terms or conditions that are not reasonably commercial. Self-insurance is best suited where events are relatively minor and more frequent; the self-insurance is more of a means of smoothing somewhat volatile expenditure. This approach is not suitable for large events such as bushfire, as there is no opportunity to diversify the risk. Further, in recent regulatory

[16] NER cl 6.6.1(a1)(1)-(4).

Criteria	Explanation
	decisions, the AER has rejected applications for self-insurance[17] meaning that even if a DNSP were to take on self-insuring, there is no way to manage the financial aspect of the risk.
Any other matter the AER considers relevant.	We consider that the changes in this nominated cost pass through event are to simply clarify the intent of what has been adopted as a pass through event previously – that is, to allow cost recovery of material un-insured losses. We consider that the AER should have regard to the global insurance market, which highlights the possibility of gaps within a program of insurance; this would not have been an issue in previous determinations due to the significant changes in the insurance market (including mergers, significant claims losses and reduction in available capacity) has occurred over the past 18 months.

3.5 New insurance premium event

3.5.1 Explanation of drafting amendments to insurance cap event

The insurance premium event we are proposing will allow JEN to pass through costs associated with material increases in premiums associated with its general liability insurance.

Because of the changes in market dynamics, JEN's operations are likely to attract higher annual liability insurance premium costs in the next regulatory period.[18] JEN is especially vulnerable to these cost increases—relative to our peers in the National Electricity Market (**NEM**), due to the relatively small size of our electricity network, and having a large proportion of our distribution areas being exposed to bushfire risks.

As discussed in Attachment 06-05, JEN is proposing an operating expenditure step change associated with insurance premiums. However, given the potential volatility in insurance premiums, we also consider that a pass through event for an "insurance premium event" is also appropriate. Specifically, the forecast increases we seek through the step change over the next regulatory period are based on a stabilisation of premiums, albeit an increase over the next regulatory period. However, that step change does not factor in any major insurance market volatility occurring in the future, for which may expose JEN to further premium increases and reductions of insurer capacity beyond those forecast in our step change.

We note that none of the other cost pass through events would allow recovery for significant increases in insurance premiums occurring within the period. This gap creates a risk that events outside of our control (in particular, major environmental catastrophes and claim activities of other insured organisations) will materially increase our insurance premium costs, but that increase (because of the uncertainty) has not been included in our approved expenditure allowances. Given the materiality of potential insurance premium rises, the difficulty in managing these costs using alternative measures, and the substantial volatility with respect to the cost impacts (for which we cannot control), we consider that proposing a nominated cost pass through event is an appropriate approach to enable us to recover our prudent and efficient costs.

Our proposed drafting of the new nominated pass through event is set out in Table 3–3 below. We explain below the basis for the drafting of the insurance premium event:

- As previously noted, the global insurance market is expected to increase its premiums for services and this is uncontrollable from JEN's perspective. We have drafted this pass through event to manage the risk of rising premiums

[17] AER, *Queensland electricity distribution network service providers Distribution Determination 2011-15, Draft Decision,* November 2009, Pg. 702.; AER *Final decision, AusNet Services distribution determination 2016 to 2020, Attachment 7 – Operating expenditure*, May 2016, Pg. 7-97.

[18] This is discussed in detail in Attachments 06-05 and 06-06.

- The items for consideration in the assessment of approving a pass through event, should one arise, provide a framework for the AER and JEN to assess the benchmark level of prudent insurance cover to ensure the premiums to be passed through are efficient, as well as ensure that the costs sought to be recovered through a pass through event are not already captured in a regulatory determination.

Table 3–3: Proposed insurance premium event

Event	Proposed definition
Insurance premium event	An insurance premium event occurs if JEN incurs costs in respect of insurance premiums which exceed the allowance for insurance premiums included in the forecast operating expenditure allowance approved in the AER's distribution determination for the 2021-26 regulatory control period. Note: Insurance premiums relate to the costs payable to obtain general liability insurance cover during the regulatory control period commencing 1 July 2021 to 30 June 2026. In making a determination on an insurance premium event, the AER will have regard to, amongst other things: i) the level of insurance cover that a prudent and efficient distribution network service provider operating a network similar to JEN's would obtain in respect of liability exposure; and ii) any assessment by the AER of JEN's general liability insurance cover in making its distribution determination for the 2021-26 regulatory control period.

3.5.2 Nominated pass through event considerations assessment

We consider that the inclusion of the insurance premium event is supported by reference to the nominated pass-through event considerations as explained in Table 3–4 below.[19]

Table 3–4: Assessment of nominated pass through event considerations in respect of insurance premium event

Criteria	Explanation
Whether the nominated insurance event is an event already covered in the NER	The cost pass-through events as outlined in the NER include (i) a regulatory change event, (ii) a service standard event, (iii) a tax change event, and (iv) a retailer insolvency event.[20] An insurance premium event would not fall within the definitions of any of these events.
Whether the nature or type of event can be clearly identified at the time the determination is made	The event, when an insurance premium is incurred, arises on an annual basis when insurance coverage is renewed. Accordingly, there is a clear understanding of the type of event and the timing of the event each year.
Whether the event could be avoided or substantially mitigate the cost impact.	JEN does not consider it possible to avoid insurance premiums given the risks faced by our business, the nature of the services we provide, and the environment in which the services are provided (that is, the high bushfire risks faced in Victoria which are a contributing factor to driving up insurance premiums and exposure to the global insurance market trends). We consider that to not hold general liability insurance, would not reflect a prudent or efficient business decision, and would be in breach of Jemena's risk management policy, the accepted market practice of our DNSP peers and the expectations of our customers and the broader community.[21] In terms of mitigating costs, JEN procures insurance through a competitive tendering processes to ensure that we obtain a cost effective insurance policy that provides a broad coverage efficiently and therefore mitigated the costs to the extent possible.[22]

19 NER, cl 6.5.10(b).

20 NER cl. 6.6.1(a1)(1)-(4).

21 Jemena, *JAA PO 0050, Risk Management Policy*, 6 June, 2018.

22 Refer to Attachment 06-05 which outlines the options analysis we undertake to procure efficient insurance services.

Criteria	Explanation
Whether the event can be insured, having regard to insurance and self-insurance	Insurance premiums themselves cannot be insured; they are the costs necessarily incurred to insure against other events. Self-insurance is also not an option as discussed in our operating expenditure step change attachment.[23]
Any other matter the AER considers relevant.	JEN has proposed an operating expenditure step change to recover the additional costs that we expect to incur in respect of liability insurance premiums over the next regulatory period. However, there is a risk that the rate of change in insurance premiums could be even greater again, exceeding the materiality threshold requirement necessary for a cost-pass-through.[24] In the circumstances, we consider that both the operating expenditure step change and the nominated pass through event are appropriate to enable JEN to recover its efficient costs in providing electricity distribution services to our customers.

23 Ibid.

24 See definition of 'materially' under chapter 10 of the NER.