



Uncertainty

**UE RRP APP04 - Uncertainty - Dec2020 -
Public**

Revised regulatory proposal 2021–2026

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1 Summary

The environment we operate within is inherently uncertain; events outside of our control can affect the quality, reliability and security of the services we provide to our customers. This has never been more so than during 2020. Whilst our revised proposal has been prepared using the best information available to us, we cannot control for every eventuality.

The uncertainty regime under the National Electricity Rules (**Rules**) comprises pass-through events, capital expenditure reopeners and contingent projects. This section of our revised proposal responds to the draft determination with respect to the pass through events that are to apply for the 2021–2026 regulatory control period in accordance with clause 6.5.10 of the Rules (nominated pass through events).

The nominated pass through event mechanism deals with expenditure that may be required during a regulatory period, but which is not able to be predicted with reasonable certainty at the time of preparing or submitting a regulatory proposal to the AER.

1.1 Summary of our revised proposal

The draft determination accepted five of our proposed nominated pass through events (being, the insurer credit risk event, insurance coverage event, natural disaster event, terrorism event and retailer insolvency event) subject to amendments. Our major cyber event, act of aggression event and electric vehicle event were not accepted.¹ Our revised proposal accepts the draft determination, save for proposing minor revisions to the AER's definition of the insurance coverage event.

In addition, in responding to the draft determination regarding operating and capital expenditure, we are also proposing three new nominated pass through events, being an insurance premiums event, an environment protection event and a pole management practices event.

¹ AER, Draft Decision United Energy Distribution Determination 2021-26, 30 September 2020, Attachment 15, p. 15-4.

2 Nominated pass through events

2.1 Background

In providing for the pass-through mechanism, the Rules recognise that a prudent and efficient distributor can be exposed to risks beyond its control, which may have a material impact on its costs. A cost pass through enables a distributor to recover the costs of defined unpredictable, high-cost events, not built into a distribution determination.

2.2 Rule requirements

In addition to the pass through events contemplated by the Rules, clause 6.5.10(a) of the Rules provides that distributors can include 'nominated pass through events' in their regulatory proposals. In determining whether to accept a distributor's proposed nominated pass through event, the AER must take into account the 'nominated pass through event considerations' set out in the Rules.

The 'nominated pass through event considerations' are relevantly defined in chapter 10 of the Rules to be:

- whether the event proposed is an event covered by a category of pass through event specified in clause 6.6.1(a1)(1) to (4)
- whether the nature or type of event can be clearly identified at the time the determination is made for the service provider
- whether a prudent service provider could reasonably prevent an event of that nature or type from occurring or substantially mitigate the cost impact of such an event
- whether the relevant service provider could insure against the event, having regard to:
 - the availability (including the extent of availability in terms of liability limits) of insurance against the event on reasonable commercial terms; or
 - whether the event can be self-insured on the basis that:
 - it is possible to calculate the self-insurance premium; and
 - the potential cost to the relevant service provider would not have a significant impact on the service provider's ability to provide network services; and
- any other matter the AER considers relevant and which the AER has notified network service providers is a nominated pass through event consideration.
- In addition, the AER must:
 - perform or exercise a function or power under the National Electricity Law (**Law**) or the Rules that relates to the making of a distribution determination in a manner that will or is likely to contribute to the achievement of the national electricity objective (**NEO**)² and
 - in making a distribution determination, if there are two or more decisions that will or are likely to contribute to the achievement of the NEO, the AER must make the decision that it is satisfied will or is likely to contribute to the achievement of the NEO to the greatest degree.³

² Law, section 16(1)(a) and section 2(1) definition of 'AER economic regulatory function or power'.

³ Law, section 16(1)(d) and sections 2(1) and 71A definitions of 'reviewable regulatory decision'.

Finally, the AER must take into account the revenue and pricing principles when exercising a discretion in making those parts of a distribution determination relating to direct control network services.⁴ The revenue and pricing principles are set out in section 7A of the Law and relevantly include:

(2) A regulated network service provider should be provided with a reasonable opportunity to recover at least the efficient costs the operator incurs in–

(a) providing direct control network services; and

(b) complying with a regulatory obligation or requirement or making a regulatory payment.

(3) A regulated network service provider should be provided with effective incentives in order to promote economic efficiency with respect to direct control network services the operator provides. The economic efficiency that should be promoted includes–

(c) efficient investment in a distribution system ... with which the operator provides direct control network services; and

(d) the efficient provision of electricity network services; and

(e) the efficient use of the distribution system ... with which the operator provides direct control network services.

...

(5) A price or charge for the provision of a direct control network service should allow for a return commensurate with the regulatory and commercial risks involved in providing the direct control network service to which that price or charge relates.

2.3 Original proposal

Our original proposal included nominated pass through events for an insurer credit risk event, an insurance coverage event, a natural disaster event, a terrorism event, a retailer insolvency event, a major cyber event, an act of aggression event and an electric vehicle event.

The definitions we proposed in respect of each event are set out in the following table.

⁴ Law, section 16(2)(a).

Table 1 Nominated pass through events proposed in our original regulatory proposal

| Nominated pass through event | Definition proposed in original proposal |
|------------------------------|--|
| Insurer credit risk event | <p>An insurer's credit risk event occurs if an insurer of United Energy becomes insolvent and as a result, in respect of an existing or potential insurance claim for a risk that was insured by the insolvent insurer, United Energy:</p> <ul style="list-style-type: none"> (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. <p>Note: In assessing an insurer's credit risk event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> (a) United Energy's attempts to mitigate and prevent the event from occurring by reviewing and considering the insurer's track record, size, credit rating and reputation (b) in the event that a claim would have been made after the insurance provider became insolvent, whether United Energy had reasonable opportunity to insure the risk with a different provider. |
| Insurance coverage event | <p>An insurance coverage event occurs if:</p> <ul style="list-style-type: none"> (a) United Energy makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy or program of insurance policies (b) United Energy incurs costs beyond the policy limit, or which otherwise fall outside the scope of the cover provided, under the relevant insurance policy or policies (c) the costs beyond the policy limit, or otherwise outside the scope of the cover provided, under the relevant insurance policy or policies increase the costs to United Energy in providing direct control services. <p>For this insurance coverage event:</p> <ul style="list-style-type: none"> (a) a relevant insurance policy is an insurance policy held during the 2021–2026 regulatory control period or a previous regulatory control period in which United Energy was regulated (b) the scope of the cover provided by a relevant insurance policy or policies includes the bands of liability for which United Energy is insured. It does not include: <ul style="list-style-type: none"> (1) any liability beyond the policy limit of the policy or policies or (2) any range or band of liability within the policy limit for which United Energy is not insured by the policy or policies (c) United Energy will be deemed to have made a claim on a relevant insurance policy if the claim is made by a related party of United Energy in relation to any aspect of the Network or United Energy's business. <p>Note in assessing an insurance coverage event pass through application the AER will have regard to:</p> <ul style="list-style-type: none"> (a) the insurance policy or policies for the event (b) the level and scope of insurance cover that would be obtained, and the risks that would be insured against, by an efficient and prudent NSP in respect of the event (c) prevailing conditions in the global insurance market at the time the policy or program of policies was obtained. |

| Nominated pass through event | Definition proposed in original proposal |
|------------------------------|---|
| Natural disaster event | <p>Natural disaster event means any natural disaster including but not limited to cyclone, fire, flood or earthquake that occurs during the 2021–26 regulatory control period that increases the costs to United Energy in providing direct control services, provided the cyclone, fire, flood, earthquake or other event was not directly and solely caused by United Energy’s negligent or unlawful acts or omissions.</p> <p>Note: In assessing a natural disaster event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> (a) whether United Energy has insurance against the event (b) the level of insurance that an efficient and prudent NSP would obtain in respect of the event (c) whether a relevant government authority has made a declaration that a natural disaster has occurred. |
| A terrorism event | <p>Terrorism event means an act (including, but not limited to, the use of force or violence or the threat of force or violence, attacks or other disruptive activities against critical infrastructure or underlying technology, or the threat of such attacks or disruptive activities, or the deliberate introduction of malware) of any person or group of persons (whether acting alone or on behalf of or in connection with any organisation or government), which:</p> <ul style="list-style-type: none"> (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 United Energy in providing direct control services. <p>Note: In assessing a terrorism event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> (a) whether United Energy has insurance against the event (b) the level of insurance that an efficient and prudent DNSP would obtain in respect of the event (c) whether a declaration has been made by a relevant government authority that an act of terrorism has occurred. |
| Retailer insolvency event | <p>Until such time as the National Energy Retail Law set out in the Schedule to the National Energy Retail Law (South Australia) Act 2011 of South Australia is applied as a law of Victoria, retailer insolvency event has the meaning set out in the NER as in force from time to time, except that:</p> <ul style="list-style-type: none"> (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) (b) other terms used in the definition of retailer insolvency event in the Rules as a consequence of amendments made to that definition from time to time, which would otherwise take their meaning by reference to provisions of the NER or National Energy Retail Law not in force in Victoria, take their ordinary meaning and natural meaning, or their technical meaning (as the case may be). <p>For the purposes of this definition, the terms 'eligible pass through amount' and 'positive change event' where they appear in the NER are modified in respect of this retailer insolvency event in the same manner as those terms are modified in respect of the retailer insolvency event prescribed in the NER from time to time. Other terms defined in the NER for this purpose (including without limitation 'retailer insolvency costs', 'failed retailer' and 'billed but unpaid charges') which would otherwise take their meaning by reference to provisions of the NER or National Energy Retail Law not in force in Victoria, take their ordinary and natural meaning, or their technical meaning (as the case may be).</p> <p>Note: This retailer insolvency event will cease to apply as a nominated pass through event on commencement of the National Energy Retail Law in Victoria.</p> |

| | |
|-------------------------|--|
| Major cyber event | <p>Major cyber event' means any significant interruption to the technology systems or assets used by United Energy to provide direct control services occurring during the 2021–2026 regulatory control period that materially increases the costs to United Energy in providing direct control services, provided that:</p> <ul style="list-style-type: none"> (a) the interruption was caused by an act of a third party (b) the event does not constitute a 'terrorism event'. <p>Note: In assessing a major cyber event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> (a) whether United Energy has insurance against the event (b) the level of insurance that an efficient and prudent DNSP would obtain in respect of the event (c) whether the steps taken by United Energy to prevent the event from occurring are consistent with the steps that an efficient and prudent DNSP would have taken in the circumstances to prevent the occurrence of the event (d) whether the steps taken by United Energy to mitigate the cost impact of the event are consistent with the steps that an efficient and prudent DNSP would have taken in the circumstances to mitigate the cost impact of the event. |
| Act of aggression event | <p>Act of aggression event means:</p> <ul style="list-style-type: none"> (a) an event that constitutes an international armed conflict (within the meaning given to that term by the Geneva Conventions and associated Protocols) involving Australia; (b) an event that constitutes a non-international armed conflict (within the meaning given to that term by the Geneva Conventions and associated Protocols) occurring in Australia; or (c) an act of aggression (within the meaning given to that term by United Nations General Assembly resolution 3314 (XXIX) of 14 December 1974) against Australia, <p>which occurs during the 2021–2026 regulatory control period and materially increases the costs to United Energy in providing direct control services.</p> <p>Note: In assessing an act of aggression event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> (a) whether United Energy has insurance against the event (b) the level of insurance that an efficient and prudent distributor would obtain in respect of the event |
| Electric vehicle event | <p>An electric vehicle event occurs if a government announcement directly related to increased electric vehicle uptake occurs during the 2021–2026 regulatory period that materially increases localised electricity demand</p> <p>Note: In assessing an electric vehicle risk event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> (a) United Energy's attempts to mitigate the impact of the event on localised electricity demand (b) whether the event already satisfies a regulatory change event in the Rules |

Source: United Energy

2.4 Draft determination

2.4.1 Pass through events

The draft determination accepted five of our proposed nominated pass through events (being, the insurer credit risk event, insurance coverage event, natural disaster event, terrorism event and retailer insolvency event) subject to amendments. The AER did not accept our major cyber event, act of aggression event or electric vehicle event.⁵

A summary of the draft determination in respect of each of the nominated pass through events we proposed in our original proposal is given in the below table.

Table 2 Summary of draft determination in respect of nominated pass through events

| Event | Changes proposed in original proposal | Draft determination |
|---------------------------|--|--|
| Insurer credit risk event | Consistent with current definition and definition accepted by AER in recent regulatory decisions | Accepted |
| Insurance coverage event | Amendment from the current 'insurance cap event' having regard to the changes and challenges in the global insurance market that have increased the risk of inability to obtain the full level or scope of cover under relevant insurance policy or policies | Further amendment to the definition to allow for changes to insurance coverage where there are 'changed circumstances' Requested submissions on further amendments to the definition proposed by Jemena |
| Natural disaster event | Minor amendment to current definition and consistent with recent AER regulatory decisions | Further amendment to the definition in respect of how it applies to events caused by our acts or omissions |
| A terrorism event | Current definition amended to include specific reference to cyber terrorism | Our change was not accepted |
| Retailer insolvency event | Minor amendment from current definition having regard to the current definition of the retailer insolvency event in the Rules | Slight amendment to the event's definition to reflect legislative changes |
| Major cyber event | Additional event with definition that addresses AER reservations expressed in recent decisions | Not accepted |
| Act of aggression event | Additional event added with definition that addresses AER reservations with this event expressed in recent regulatory decisions | Not accepted |
| Electric vehicle event | Additional event added to address the uncertainty with electric vehicle uptake | Not accepted |

Source: United Energy

⁵ AER, Draft Decision United Energy Distribution Determination 2021-26, 30 September 2020, Attachment 15, p. 15-4.

2.5 Our response to the draft determination

Our revised proposal accepts the draft determination regarding the pass through events in our original proposal, save for proposing minor revisions to the AER's definition of the insurance coverage event.

In addition, in responding to the draft determination regarding operating and capital expenditure, we are also proposing three new nominated pass through events, being an insurance premiums event, an environment protection event and a pole management practices event.

2.5.1 Insurance coverage event

The AER accepted our proposal to include an insurance coverage event in the distribution determination, but adopted a definition for the event consistent with recent determinations for SA Power Networks, Ergon Energy and Energex. The AER also invited us to express views on amendments to the AER's definition proposed by Jemena as part of the draft determination consultation.⁶

We agree with the changes proposed by Jemena and propose only further minor amendments to the definition by way of clarification. Our proposed insurance coverage event is set out in

Table 3 below. The event is Jemena's proposed insurance coverage event set out in Appendix A of Attachment 15 of the draft determination, with our suggested additions to Jemena's drafting underlined.

⁶ AER, Draft Decision United Energy Distribution Determination 2021-26, 30 September 2020, Attachment 15, pp. 15-13-15-14.

Table 3 Insurance coverage event definition

| Nominated pass through event | Definition proposed in revised proposal |
|------------------------------|--|
| Insurance coverage event | <p>An insurance coverage event occurs if:</p> <ol style="list-style-type: none"> 1. United Energy: <ol style="list-style-type: none"> 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. United Energy incurs costs: <ol style="list-style-type: none"> 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, <u>either separately or in aggregate</u>, materially increase the costs to United Energy in providing direct control services. <p>For the purposes of this insurance coverage event:</p> <ul style="list-style-type: none"> • <u>'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.</u> • <u>'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 United Energy, where those movements result in it no longer being possible for United Energy to take out with a reputable insurer:</u> <ol style="list-style-type: none"> 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), <p>either at all or on reasonable commercial terms.</p> • <u>'costs' means the amount that would have been recoverable under the relevant insurance policy or set of insurance policies had:</u> <ol style="list-style-type: none"> i. the limit not been exhausted; or ii. those costs not been unrecoverable due to changed circumstances. • <u>'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).</u> • <u>A relevant insurance policy or set of insurance policies is an insurance policy or set of insurance policies held during the regulatory control period or a previous regulatory control period in which United Energy was regulated.</u> • <u>United Energy will be deemed to have made a claim on a relevant insurance policy or set of insurance policies if the claim is made by a related party of United Energy in relation to any aspect of United Energy's network or business.</u> <p>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:</p> <ul style="list-style-type: none"> • The relevant insurance policy or set of insurance policies for the event; • The level of insurance that an efficient and prudent DNSP would obtain, or would have sought to obtain, in respect of the event; and • <u>Any guidance published by the AER on matters the AER will likely have regard to in assessing any insurance coverage event that occurs; and</u> • Any information provided by United Energy to the AER about United Energy's actions and processes. |

The basis for the insurance coverage event is discussed in the insurance business case 9.05, submitted with this revised proposal.

2.5.2 Insurance premiums event

As discussed in the insurance appendix, there has been a major withdrawal of insurance capacity globally for bushfire liability risks, due to a combination of insurer consolidation, appetite changes and (re)insurers being more selective in how they deploy their capacity. As a result of these changes in the insurance market, there will be a material and sustained increase in insurance premiums, as well as a decrease in the availability of insurance, in the next regulatory period.

We accept that forecasting insurance premiums is difficult. Accordingly, we are proposing:

- a step change to reflect the higher expected insurance premiums in the next regulatory period, based on the actual premium amounts incurred in the 2020/21 insurance year (rather than the expected increases as forecast by Marsh)
- an insurance premiums pass through event, to ensure that if premium increases result in the costs of direct control services increasing materially, we are provided with an opportunity to recover at least our efficient costs.

The background to the insurance premiums pass through event, the reasons why it is required to ensure we are provided with the reasonable opportunity to recover our prudent and efficient costs and the reasons it delivers appropriate regulatory outcomes in the face of the uncertainty over insurance premiums in the next regulatory period, are discussed in the insurance business case 9.05 submitted with this revised proposal.

Proposed nominated pass through event

Table 4 Insurance premiums event definition

| Nominated pass through event | Definition |
|------------------------------|---|
| Insurance premiums event | <p>An insurance premiums event occurs if United Energy incurs costs in procuring general liability insurance products during the 2021-26 regulatory control period which exceed the allowance for general liability insurance products included in the forecast operating expenditure allowance approved in the AER’s distribution determination for the 2021–26 regulatory control period for the relevant regulatory year.</p> <p>Note: In making a determination on an insurance premiums event, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> i. the level of general liability insurance cover that an efficient and prudent DNSP operating a network similar to United Energy’s would obtain in respect of liability exposure; ii. any guidance published by the AER on matters the AER will likely have regard to in assessing any insurance premiums event that occurs; and iii. any information provided by United Energy to the AER about United Energy’s actions and processes. |

Source: United Energy

Insurance premiums event satisfies the nominated pass through event considerations

Our proposed event definition is consistent with the nominated pass through event considerations as:

- the event is not covered by a category of pass through event specified in clause 6.6.1(a1)(1) to (4) of the Rules

- the event definition means that the event can be clearly identified at the time the determination is made
- as outlined in the insurance business case, despite extensive bushfire mitigation strategies, we cannot prevent the increase in the price of insurance premiums from occurring or further mitigate the cost impact of such an event
- it is not possible to insure against further rises in the price of insurance in bushfire prone areas
- as discussed in the insurance business case, wholly self-insuring for general liability would require us to hold significant capital funds to enable the making of payments to claimants and continue providing network services, which would lead to significantly higher costs of providing services compared to these risks being managed by the procurement of an appropriate level of insurance cover. It would also not be consistent with good governance and is not a commercially realistic option not to hold adequate liability insurance given our debt investors expect us to have adequate insurance cover.

2.5.3 Environment protection event

Background

We are subject to both Victorian and Commonwealth environmental obligations, including the *Environment Protection Act 1970* (Vic) (**EP Act 1970**) and the State Environment Protection Policies for noise, land, groundwater, surface water and air quality.

Historically, we have managed the risks associated with our environmental obligations primarily through a reactive approach consistent with the prevailing legislation. For example, we have investigated noise concerns associated with our zone substation transformers following a customer complaint.

In 2018, the Victorian Government passed the *Environment Protection Amendment Act 2018* (Vic) (**EP Amendment Act**). On the commencement of the EP Amendment Act, the EP Act 1970 will be repealed and replaced by a set of amendments to the *Environment Protection Act 2017* (Vic) (**New EP Act**). The New EP Act was due to commence in July 2020, along with various regulations and other instruments (**Subordinate Instruments**) (together, **New EP Regime**). As set out in the Regulatory Impact Statement (**RIS**), these revisions establish a modern regulatory regime focusing on preventing waste and pollution impacts, rather than managing any impacts after an event has occurred.⁷ The amendments are intended to shift from a 'reactive' regulatory framework to a 'proactive' framework including by the:

- imposition of a 'general environmental duty' which, relevantly, requires systems to be put in place to prevent pollution.
- imposition of specific duties to manage contaminated land and to notify the Environmental Protection Authority Victoria of specific contaminated sites.
- codification and augmentation of the existing noise framework, including by imposition of a night noise limit and giving force of law to the existing non-binding guidelines in regional Victoria.

The Victorian Government is proposing the new laws be supported by:

- Environment Protection Regulations
- Environment Reference Standard (**ERS**)
- Regulatory Impact Statement (**RIS**)

⁷ UE ATT010: Deloitte, Regulatory impact statement: proposed environment protection regulations, DELWP and EPA, August 2019, p. 7.

- Impact assessment

In September 2019, the Department of Environment, Land, Water and Planning (**DELWP**) and the EPA published, among other documents:

- draft Environment Protection Regulations (which will be made under section 465 of the amended New EP Act) together with an associated RIS
- draft Environment Protection Transitional Regulations (which will be made under section 502 of the amended New EP Act)
- a draft Environment Reference Standard (which will be made under section 93 of the amended New EP Act)
- a draft Noise Limit and Assessment Protocol (which is a document to be published by the EPA under the Environment Protection Regulations).

However, in response to the impact of coronavirus (**COVID-19**) on businesses, the commencement of the EP Amendment Act was amended by the *COVID-19 Omnibus (Emergency Measures) Act 2020* (Vic) (**COVID-19 Act**). Section 54 of that Act:

- revoked the proclamation of commencement of the EP Amendment Act made on 3 March 2020
- provides that, except for those provisions expressly provided for in the COVID-19 Act, the EP Amendment Act comes into operation on a day to be proclaimed
- provides that, if a provision of the EP Amendment Act does not come into operation by 1 December 2021, it comes into operation on that day (this end date was previously 1 December 2020).

There has not yet been a new proclamation made. However, we understand the intention is that the relevant provisions of the EP Amendment Act will commence on 1 July 2021.⁸ In addition, whereas we previously expected the Subordinate Instruments to be finalised in May 2020, in response to the postponement of the commencement of the EP Amendment Act, the Victorian Government has advised that regulations and standards will be made closer to the new commencement date.⁹

Our original proposal included capital expenditure and an operating expenditure step change in respect of compliance with the New EP Regime. However, after the deferral of the commencement of that legislation, we withdrew our proposed capital and operating expenditure associated with the changes.¹⁰ As a result, the AER did not include the expenditure proposed in respect of compliance with the New EP Regime within its alternative estimates of capital and operating expenditure in the draft determination.

We anticipate that the EP Amendment Act will now repeal the EP Act 1970 from 1 July 2021 and establish, in the form of the New EP Regime, a proactive regulatory approach to preventing waste and pollution impacts (rather than managing the impacts after they occur). However, the commencement date has not yet been proclaimed and no further information regarding the Subordinate Instruments has been made available.

⁸ See for example: DELWP, *Environment Protection Amendment Act*, 23 April 2020 <<https://www.environment.vic.gov.au/sustainability/environment-protection-reform/ep-bill-2018>; Environment Protection Authority Victoria, *Changing to the Environment Protection Amendment Act 2018* <<https://www.epa.vic.gov.au/about-epa/laws/new-laws/changing-to-the-new-act>>.

⁹ See: Environment Protection Authority, *Proposed regulations and environment reference standards* <<https://engage.vic.gov.au/new-environmental-laws/subordinate-legislation>>.

¹⁰ CitiPower, Powercor and United Energy, *Amendments to operating expenditure step changes and capital programs*, 15 May 2020, pp. 1-2.

Given that there is still considerable uncertainty with respect to the required capital expenditure we will incur in compliance with the New EP Regime, we consider that the expenditure is the proper subject of a cost pass through event, rather than forming part of the expenditure forecast in our revised proposal.

Cost impact of these changes

Whilst we do not yet have clarity on precisely the measures we will have to implement to comply with the New EP Regime (as these measures are not yet finalised), we expect our costs to include at least those elements discussed below.

Operating expenditure

The move to a proactive regulatory framework will require us to conduct more site tests, assessments and maintain this information on an ongoing basis to develop a risk-assessment framework and related mitigation plans and systems. The risk-assessment framework is necessary for reducing risk of environmental harm so far as reasonably practicable.¹¹ Remediation activity is also expected to increase substantially due to a new obligation to minimise all risks of harm to human health and the environment from contaminated land.¹²

Based on the new obligations and the expectations under the RIS, we estimate the following on-going activity will increase as a result of the new obligations and from the new risk-assessment framework:

- remediation of contaminated land, including oil removal and clean-up activities
- removal of asbestos, lead paint and PCBs.

Bunding

The New EP Regime also requires us to prevent harm so far as reasonably practicable.¹³ Transformers in zone substations present the greatest risk to environmental protection, in the form of soil contamination. This is due to the risk of transformers leaking material volumes of oil as their condition deteriorates. One of the most effective treatments for transformer oil leak risk is to contain and treat leaks via bund walls. A bund wall is a complete enclosure built around the transformer that contains any oil spills within the wall boundary until such time that they can be treated or removed. Coupled to this is the treatment of water at the site to separate oil from water before it enters the storm water or ground water.

We install bunding and drainage at new zone substations, when replacing and upgrading transformers and in cases of serious leaks and risk of water drainage. However, in light of the requirements of the New EP Regime, we have developed a program of works to install or upgrade bunding at all existing transformers over time. This will significantly reduce the risk of oil contamination, which is consistent with the EP Amendment Act 2018 and the draft regulations.

Noise compliance

The New EP Regime will establish offences of 'unreasonable noise' and 'aggravated noise' by non-residential premises in major urban areas and in rural areas, and introduce new night time limits and the consideration of the frequency spectrum.¹⁴

We have conducted a desktop risk-assessment to identify the potential non-compliant zone substations with regard to the new night time limits. These are based on indicative night time emission limit exceedances from

¹¹ This duty arises from the new General Environmental Duty: New EP Act, section 25(1).

¹² This duty arises from the new Duty to Manage: New EP Act, section 39(1).

¹³ This duty arises from the new General Environmental Duty: New EP Act, section 25(1).

¹⁴ New EP Act, sections 166 and 168.

previous studies. Sites with indicative night-time noise exceedances are considered to be high-risk, and as such were included in the phased planned works for mitigation over the 2021–2026 regulatory period.

We engaged GHD Pty Ltd (**GHD**) to undertake a cost feasibility assessment for mitigating noise across those higher risk zone substitutions in our network¹⁵. To identify and assess various options, GHD completed structural design and noise modelling to assess the feasibility of various noise mitigation solutions. GHD also engaged with an external quantity surveyor to obtain an understanding of indicative costs associated with each solution provided. The estimated capital expenditure represents the least-cost option identified by GHD for each site.

Proposed expenditure

Table 5 Environment protection required works

| Description | Investment (\$million, 2019) |
|----------------------------|------------------------------|
| Operating expenditure | 10.85 |
| Noise compliance program | 66.71 |
| Bunding compliance program | 12.65 |
| Total | 90.21 |

Source: United Energy

Proposed nominated pass through event

We consider that the commencement of the New EP Regime may constitute a 'service standard event', or failing that, a 'regulatory change event' as defined in the Rules. However, in light of the unprecedented impact COVID-19 has had on the progression of the New EP Regime, to put beyond doubt that the costs associated with the New EP Regime are recoverable, we are seeking a nominated pass through event for the 2021-2026 regulatory period. The definition we propose is below.

Table 6 Environment protection event definition

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

Source: United Energy

¹⁵ For the full GHD report refer to UE ATT038.

Environment protection event satisfies the nominated pass through event considerations and is consistent with the Rules and Law

As noted above, while we consider that the commencement of the New EP Regime may constitute a 'service standard event', or failing that, a 'regulatory change event' as defined in the Rules, in light of the unprecedented impact COVID-19 has had on the progression of the New EP Regime, to put beyond doubt that the costs associated with the New EP Regime are recoverable, we are seeking a nominated pass through event for the 2021-2026 regulatory period.

The nominated pass through event considerations include, 'whether the event proposed is an event covered by a category of pass through event specified in clause 6.6.1(a1)(1) to (4)'. We note in this regard that, if a proposed nominated pass through event does not satisfy a nominated pass through event consideration, this does not preclude the AER from including the event in a distribution determination. The considerations are simply matters that the AER must 'take into account' in making its determination.¹⁶

To the extent the AER considers one of the prescribed pass through events does apply to the New EP Regime changes in their entirety, and we are entitled to seek recovery of our costs under one of the prescribed pass through event provisions after the content of the New EP Regime is known with greater certainty, we would welcome the AER's decision in that regard.

Our proposed event definition is consistent with the balance of the nominated pass through event considerations as:

- the event definition means that the event can be, and is, clearly identified
- the form of the New EP Regime and the subsequent proactive steps required of us are matters outside of our control. Whilst to date, we have invested in and maintained our network as prudently and efficiently as possible, we cannot mitigate against the commencement of changing obligations
- the event is not an eventuality that we could insure against
- we have not been notified of any other relevant nominated pass through event considerations by the AER.

Should the proposed event not be covered by a 'service standard event', or 'regulatory change event' as defined in the Rules, in the absence of the nominated environment protection event, we will not be afforded a reasonable opportunity to recover our efficient costs of compliance with the New EP Regime, as provided for in the Law.¹⁷

2.5.4 Pole management practices event

We are subject to section 98 of the *Electricity Safety Act 1998* (Vic) which obliges us to design, construct, operate, maintain and decommission our supply network to minimise as far as practicable:

- the hazards and risks to the safety of any person arising from the supply network; and
- the hazards and risks of damage to the property of any person arising from the supply network; and
- the bushfire danger arising from the supply network.

¹⁶ Rules, clause 6.5.10. See also: AEMC, *Rule Determination, National Electricity Amendment (Cost pass through arrangements for Network Service Providers) Rule 2012*, 2 August 2012, 7, which states: "The nominated pass through event considerations are only intended to be high level considerations rather than to operate individually as an explicit basis to accept or reject a cost pass through. This is because different pass through events will require different weight to be given to different considerations".

¹⁷ Law, sections 7A, 16(2)(a).

Our customers consider maintaining the safety of our network to be our core business and have indicated that it should be one of our greatest priorities.

These considerations have led to us reconsidering our pole management practices. The pole management program proposed in our revised proposal will allow us to comply with our safety obligations, as well as meet community expectations in relation to a sustainable asset management program over the longer-term.

Our original proposal

Our existing asset management approach for poles reflects a condition-based replacement program. To date, this approach has resulted in our network having amongst the lowest wood pole failure rates in Australia. Notwithstanding our historical low failure rates, recent industry experience demonstrates heightened probabilities and consequences of failures focused on lower durability pole types. This includes Energy Safe Victoria's (ESV) recent reviews of Powercor's wood pole management practices, in which the regulator supported changes to assumptions regarding the fibre-strength of wood poles.¹⁸

As a prudent network operator, the above factors have driven further consideration of our own pole management practices. As a result, our original proposal included \$90.2 million of pole replacement and reinforcement expenditure. Further detail is given in our pole replacement business case.¹⁹

The draft determination

Our concrete pole management program was supported by stakeholders and accepted by the AER. In contrast, stakeholders and the AER considered there was insufficient justification for the forecast increase in replacement volumes (reflected in our condition and risk driven forecasts) and the draft determination reduced our forecast replacement expenditure on the basis of historical expenditure.²⁰

Our revised regulatory proposal

In response to feedback from stakeholders, we have not included our incremental risk-driven wood pole replacement program in our revised capital expenditure forecast. In addition, since our original proposal, we have further tested our pole condition data, and calibrated observed decay rates to match our historical intervention performance over the current regulatory period. Our condition data and decay rate analysis support the increased trend reflected in our condition-driven forecast. As such, we continue to propose increased condition-driven capital expenditure in our revised proposal.²¹

ESV has now accepted Powercor's pole management improvement plan and we expect ESV to commence a review of our own pole management practices in early-2021. Should ESV require further changes to our pole management practices, we need to ensure that we are able to recover our costs of compliance. Given the findings of ESV, and the form any recommendations or actions required will take, are currently unknown, we are proposing a nominated pass through event to enable us to recover any additional pole management expenditure required following the conclusion of ESV's investigation of our pole management practices.

Proposed nominated pass through event

We are proposing a nominated pass through event to ensure we continue to be able to comply with our regulatory obligation to operate and maintain our network to minimise, as far as possible, any risk to the safety

¹⁸ UE ATT108: ESV, *The condition of power poles in south west Victoria, Technical investigation report*, July 2019; ESV, *Draft report: Powercor wood pole management, An assessment of sustainable wood pole safety outcomes, Public technical report*, December 2019.

¹⁹ UE BUS 4.02: United Energy, Pole replacement forecast, January 2020.

²⁰ AER, Draft Decision United Energy Distribution Determination 2021-26, 30 September 2020, Attachment 5, pp. 5-22-5-25.

²¹ For more information, please see our revised Poles chapter.

of our customers, damage to their property, or any bushfire danger.²² If ESV does make further recommendations or require action in respect of our pole management practices, we need to be able to implement these recommendations and recover our efficient costs of doing so.

The definition we propose is below.

Table 7 Pole management practices event definition

| Nominated pass through event | Definition |
|---------------------------------|--|
| Pole management practices event | <p>A pole management practices event occurs if:</p> <ol style="list-style-type: none"> 1. Energy Safe Victoria has made a recommendation or recommendations or otherwise requires United Energy to take action in respect of United Energy's pole management practices; and 2. United Energy has prepared, and approved internally, changes to its pole management practices in response to the matters referred to in paragraph 1 above; and 3. United Energy has completed a forecast of pole management costs that it is likely to incur as a result of its changed pole management practices that are additional to the pole management costs that were included in the capital expenditure forecast in the AER's distribution determination for the 2021-26 regulatory control period. |

Source: United Energy

Pole management practices event satisfies the nominated pass through event considerations and is consistent with the Rules and Law

As noted above, one of the nominated pass through event considerations is whether the event proposed is an event covered by a category of pass through event specified in the Rules. Given the uncertainty as to what will transpire at the conclusion of ESV's investigation, it is unclear whether the pass through events defined in the Rules will enable us to recover our prudent and efficient costs of responding to ESV's recommendations or other required actions in relation to our pole management practices. A nominated pass through event is therefore required to ensure we will be provided with a reasonable opportunity to recover our efficient costs of complying with section 98 of the *Electricity Safety Act 1998* (Vic).²³

In any event, even if a proposed nominated pass through event does not satisfy a nominated pass through event consideration, this does not preclude the AER from including the event in a distribution determination. The considerations are simply matters that the AER must 'take into account' in making its determination.²⁴ The fact that we *may* be able to rely on the cost pass through events defined in the Rules does not prevent the AER from including our proposed nominated pass through event in the determination to put beyond doubt that we will be provided with the opportunity to recover our efficient costs of complying with applicable safety obligations.

²² In accordance with section 98 of the *Electricity Safety Act 1998* (Vic). This obligation is a regulatory obligation or requirement as it is a distribution system safety duty, being a duty or requirement under the *Electricity Safety Act 1998* (Vic) which is an act of Victoria, a participating jurisdiction, relating to the safe distribution of electricity in that jurisdiction and the safe operation of a distribution system in that jurisdiction: Law, section 2D and definition of 'distribution system safety duty'.

²³ Law, sections 7A, 16(2)(a).

²⁴ Rules, clause 6.5.10. See also: AEMC, *Rule Determination, National Electricity Amendment (Cost pass through arrangements for Network Service Providers) Rule 2012*, 2 August 2012, 7, which states: "The nominated pass through event considerations are only intended to be high level considerations rather than to operate individually as an explicit basis to accept or reject a cost pass through. This is because different pass through events will require different weight to be given to different considerations".

Our proposed event definition is consistent with the balance of the nominated pass through event considerations as:

- the event definition as drafted means that the event can be, and is, clearly identified
- whilst we have appropriately management our pole assets to date, we cannot prevent ESV recommending that more stringent practices are required in order for us to continue to operate and maintain our network to minimise, as far as possible, any risk to the safety of our customers, damage to their property, and any bushfire danger. Given the risks posed to our customers and the wider community, it would be inappropriate not to put such recommendations into practice
- the event is not a circumstance that we could insure against
- we have not been notified of any other relevant nominated pass through event considerations by the AER.