Jemena Gas Networks (NSW) Ltd

2025 - 2030 Access Arrangement Proposal

Attachment 10.2

Cost pass through mechanisms

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List of appendices

Abbreviations

2020-25 AA	JGN’s current Access Arrangement for the 2020-25 regulatory period
2025-30 AA	JGN’s proposed Access Arrangement for the 2025-30 regulatory period
AA	Access Arrangement
AER	Australian Energy Regulator
CESS	Capital Expenditure Sharing Scheme
CPI	Consumer Price Index
JGN	Jemena Gas Networks (NSW) Ltd
NGL	National Gas Law
NGR	National Gas Rules
RSA	Reference Service Agreement
UAG	Unaccounted for Gas
WACC	Weighted Average Cost of Capital

Overview

Our 2025 Plan includes our proposed revenue requirement to deliver the transportation reference service and the ancillary reference services for the 2025-30 Access Arrangement period. We forecast our revenue requirement using the building block approach, which, amongst other things, relies on forecasts of our capital and operating expenditure (capex and opex) and an allowed rate of return. *JGN - Att 7.1 - Revenue and price path* details our forecast revenue requirement.

We recover revenue from our customers for our transportation reference services and ancillary reference services via tariffs. *JGN - Att 10.1 - Pricing* details our proposed approach to setting transportation and ancillary reference tariffs for the regulatory year (**RY**) 2025-26. Our proposed transportation reference tariffs are included in *JGN - Att 7.6.2M - PTRM - Step 2*, while our proposed ancillary reference tariffs are included in *JGN - Att 7.2M - Ancillary reference services model*. In the 2020-25 AA, we included a variation mechanism to adjust our reference tariffs annually. We propose retaining this mechanism for the 2025-26 period for Transportation Reference Tariffs. We also propose a new individual price cap mechanism to apply to ancillary reference services.

Our current mechanisms deal with two types of costs that are passed through:

1. those that pass-through automatically each year based on updates to observable data – we refer to these as 'Automatic Adjustments'.
2. those that are contingent on the occurrence of an external event (e.g. terrorism, natural disaster, retailer insolvency) – which we refer to as a 'Cost Pass Through Event'.

The Automatic Adjustments, which are an administrative annual true-up, ensure transportation reference tariffs increase or decrease when our (or benchmark) actual and forecast costs vary for licence fees, UAG, carbon costs or new or changed relevant taxes. As this mechanism has a zero threshold, customers are assured to pay no more than the actual costs for any of these items. JGN monitors external change through its Regulation and Corporate Affairs teams to understand the impact of change on its costs and whether these warrant a negative pass through. Further detail on the Automatic Adjustments is set out in *JGN - Att 10.1 – Pricing.*

In the case of Cost Pass Through Events, it is not a precise science to forecast costs to determine our revenue requirement for the next five years. We do not know whether certain events will occur – such as natural disasters, shifts in Government policy and changes in the way the energy market works – and if they do, how they will change our costs of providing pipeline services over the 2025-30 period.

We have not included in our forecast revenue the unforeseen and uncontrollable costs that might arise in the 2025-30 period. Instead, the AER can consider and if appropriate approve cost pass through events which enable us to vary our transportation or ancillary reference tariffs if these events do occur. These are the safeguards the AER allows to adjust our tariffs up, or down, in response to the impact of unforeseen, uncontrollable and material changes. They mean that our forecast opex and capex do not include any large speculative allowances for events that may not actually happen and therefore customers should not pay. The cost pass through mechanism keeps the focus on affordability, as it is in our customers' best interests only to pay what is necessary for us to deliver the pipeline services they need.

This document details our proposed Cost Pass Through Events for the 2025-30 period, as well as the fixed principle which applies for cross-period events.

- For completeness, we note that consistent with the separation of the reference service into two references services, we have, in addition to the annual transportation reference tariff variation mechanism, proposed an annual ancillary reference tariff variation mechanism. This mechanism also applies Cost Pass Through Events. This mechanism and the tariff variation mechanism which adjusts transportation reference tariffs for Cost Pass Through Events (as well as the Automatic Adjustments) approved by the AER are described in *JGN - Att 10.1 - Pricing.*

Despite the challenges in developing a revenue forecast during a period where there is substantial regulatory and policy change and significant uncertainty surrounding the future role of gas networks in the Australian energy landscape, we have only proposed changes to the Cost Pass Through Events as a response to the AER's recent regulatory decisions, to harmonise with other regulated distribution businesses the AER regulates.

Table OV–1 details our proposed positions on the Cost Pass Through Events for the 2025-30 period.

Table OV–1: Proposed Cost Pass Through Events

Cost Pass Through Event	Position	Action
Terrorism event	Retain	No change to definition as already consistent with AER decisions
Natural disaster event	Retain	No change to definition as already consistent with AER decisions
Insurance cap event	Amend	Amend definition for consistency with recent AER decisions
Insurer credit risk event	Retain	No change to definition as already consistent with AER decisions
Regulatory change event	Retain	No change to definition as already consistent with AER decisions1
Service standard event	Amend	Change proposed to ensure all relevant decisions are captured1
Tax Change Event	Propose	Proposed definition for consistency with recent AER decisions

Section 1 provides further detail on the proposed Cost Pass Through Events and section 2 describes the continuance of the fixed principle applying to cross period events which was also contained in our 2015-20 AA and 2020-25 AA.

We do not rely solely on the cost pass through mechanisms to recover costs for unforeseen events, but are committed to robust and proactive risk management as set out in Appendix A.

List of supporting attachments

Table OV–2: List of supporting attachments

Attachment	Name	Author
7.1	Revenue and price path	JGN
7.2M	Ancillary reference services model	JGN
7.6.1M	PTRM	JGN
7.6.2M	PTRM	JGN
10.1	Pricing	JGN

- [1] Definition includes minor change(s) to reflect the separation of the reference services.

1. Cost pass through events

The NGR allows an AA to set out defined events which, if they occur during the period of the AA and increase actual costs, may permit a tariff variation to enable the service provider to recover increased costs it has actually incurred over its regulatory allowance.

We propose:

- retaining four of the six cost pass through events without amendment: terrorism event; natural disaster event; insurer credit risk event and regulatory change event;
- including a new tax change event, to align with the AER decision for other distribution businesses;
- amending the definition of insurance cap event for consistency with recent AER decisions; and
- amending the service standard event, to ensure all types of relevant decisions are covered.

In addition to the changes to some of the cost pass through events, there are several minor amendments proposed to the cost pass through provision itself, including as set out in clause 3.5(c) (as it has been numbered in the 2025-30 AA):

> *…the change in costs (as opposed to the revenue impact) that the Service Provider has incurred or is likely to incur in any Financial Year of the Access Arrangement Period, as a result of that event, exceeds one per cent of the smoothed Total Revenue for that Financial Year approved by the AER in the JGN Revenue Model.*

The addition of the words “in the JGN Revenue Model” is for clarification purposes[2].

We also note for clarity that the definition of “Total Revenue” has been amended to clarify that it refers to the Total Revenue for the Transportation Reference Service. This amendment is considered to be a necessary clarification due to the split of the Reference Service into two reference services, whereby revenue does not need to be determined for Ancillary Reference Services.

We also propose to retain the current process for application and AER approval of a Cost Pass Through Event, including the materiality threshold, which the AER approved in clause 3.4 the 2020-25 AA. This materiality threshold is consistent with what currently applies to cost pass through events for other gas distribution businesses (**GDB**s) and electricity distribution network service providers (**DNSP**s). We apply this threshold for both positive events that increase our costs and negative events that decrease our costs.

1.1 Terrorism event

“Terrorism event” is currently defined in Schedule 1 of the 2020-25 AA. We propose to retain this definition as currently drafted in the 2025-30 AA. The justifications remain applicable and the description of the event is consistent with other GDBs.

We initially proposed and intend to retain the “terrorism event” cost pass through because:

- we have a risk assessment framework to proactively mitigate the security risk to our network and non-network assets; and
- full insurance coverage via external insurance is prohibitive.

[2] JGN Revenue Model is the revenue model that is used by JGN to calculate Transportation Reference Service Tariffs for the Access Arrangement Period.

1.2 Natural disaster event

“Natural disaster event” is currently defined in Schedule 1 of the 2020-25 AA. We propose to retain this definition as currently drafted in the 2025-30 AA. The justifications remain applicable and the description of the event is consistent with other GDBs.

We proposed a “natural disaster event” because it:

- is a key category of uncertain, potentially high cost-impact events that are outside of our control;
- typically results in us incurring substantial costs for emergency response, repair and rectification works;
- is not covered by our proposed opex allowance for emergency response, which relates to the base year;
- is mitigated through our resilience framework and associated plans and available insurance; and
- is prohibitively costly to cover by full insurance.

1.3 Insurer credit risk event

“Insurer credit risk event” is currently defined in Schedule 1 of the 2020-25 AA. We propose to retain this definition as currently drafted in the 2025-30 AA. The justifications remain applicable and the description of the event is consistent with other GDBs. We proposed an insurer credit risk event because:

- we take precautions to mitigate our exposure to an insurer's credit risk event, including:
  - Appointing a global insurance broker, which ensures that all of our insurers are rated Standard and Poor's (or equivalent) A- or better;
  - Receiving quarterly insurer security rating reports; and
  - Diversifying our insurance portfolio across different third-party insurance providers;
- despite these efforts, an insurer may fail and leave us exposed in circumstance beyond our control; and
- despite being a prudent GDB, we cannot always anticipate the failure of an insurance provider.

1.4 Regulatory change event

“Regulatory change event” is currently defined in Schedule 1 of the 2020-25 AA. We propose to retain this definition as currently drafted in the 2025-30 AA, because the description of the event is consistent with other GDBs and consider it critical to retail, given the significant uncertainty facing the gas industry in the upcoming period and the likelihood of ongoing increased regulatory change.

1.5 Insurance cap event

“Insurance cap event” is currently defined in Schedule 1 of the 2020-25 AA. We proposed this event because although we hold efficient levels of insurance cover commensurate with our assessment of business risk and undertake periodic reviews of our insurances, this cost pass through event is necessary to allow us to properly manage exposure to the risk of liabilities crystallising over and above our insurance levels without incurring excessive insurance costs upfront. This justification equally applies to the 2025-30 period. We therefore propose retaining this event, but amending it for consistency with other GDBs.

We note that the drafting approved by the AER for other GDBs, such as in AGN’s AA 2023-26 is substantially the same, but not identical to the drafting approved by the AER for Jemena Electricity Network’s Distribution Determination 2021-26, but the differences appear immaterial. On this basis, we have elected to incorporate the drafting approved by the AER for Jemena Electricity Network, with minor variations to adapt this clause to JGN’s business as follows:

Insurance Cap Event means an event where:

(a) the Service Provider:

~~(a)~~(i) 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

(ii) 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

~~(a)~~(b) the Service Provider incurs costs~~;~~

(i) beyond the relevant policy limit for that policy or set of insurance policies; ~~and~~;or

(ii) that are unrecoverable under a policy or set of insurance policies due to changed circumstances; and

~~(b)~~(c) the costs referred to in paragraph (b) above ~~beyond the relevant policy limit for that policy or set of insurance policies~~ increase the costs to the Service Provider of providing the Transportation Reference Service~~.~~ and/or the Ancillary Reference Service.

For this Insurance Cap Event:

(d) 'changed circumstances' means movements in the relevant insurance liability market that are beyond the control of the Service Provider, where those movements mean that it is no longer possible for the Service Provider to take out an insurance policy or set of insurance policies at all or on reasonable commercial terms that include some or all of the costs referred to in paragraph (b) above within the scope of that insurance policy or set of insurance policies;

(e) 'costs' means the costs that would have been recovered under the insurance policy or set of insurance policies had:

(i) the limit not been exhausted; or

(ii) those costs not been unrecoverable due to changed circumstances;

~~(c)~~(f) a relevant insurance policy is an insurance policy or set of insurance policies held during the Access Arrangement Period or a previous period in which access to the pipeline services was regulated; ~~and~~

~~(d)~~(g) the Service Provider will be deemed to have made a claim on a relevant insurance policy if the claim is made by a related party of the Service Provider in relation to any aspect of the Network or the Service Provider's business~~.~~; and

(h) the Service Provider will be deemed to have been able to make a claim on a relevant insurance policy or set of insurance policies if, but for changed circumstances, the claim could have been made by a related party of the Service Provider in relation to any aspect of the Network or the Service Provider's business.

Note for the avoidance of doubt, in making a determination on an Insurance Cap Event pursuant to clause 3.45(j), the AER will have regard to, amongst other things:

(i) the relevant insurance policy or set of insurance policies for the event;~~,~~ ~~and~~

(ii) the level of insurance that an efficient and prudent service provider would obtain, or would have sought to obtain, in respect of the event;

(iii) any information provided by the Service Provider to the AER about the Service Provider's actions and processes; and

(iv) any guidance published by the AER on the matters the AER will likely have regard to in assessing any Insurance Cap Event that occurs.

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1.6 Service standard event

We propose to retain the Service Standard Event cost pass through in the 2025-30 AA with an amendment to clarify that in addition to legislative and administrative acts or decisions it would also apply in circumstances where judicial decisions have the same effect. We consider this a gap in the current drafting and for completeness propose the amendment so that a Service Standard Event cost pass through applies in the same way to all three sources of decision (ie. legislative, administrative or judicial). We have also taken the opportunity to amend subclause (a) to the definition of Service Standard Event to more clearly accommodate circumstances where a decision requires JGN to determine how the Reference Service must actually be varied (ie. in circumstances where the legislative, administrative or judicial decision will require change but does not expressly set out how the Reference Service must be changed).

1.7 Tax Change Event

We propose to adopt a cost pass through for Tax Change Events. We submit this is consistent with pass through regimes accepted by the AER in other regulatory determinations and is consistent with how exposure to such unanticipated risk can be best mitigated. We have reviewed definitions for Tax Change Events previously accepted by the AER and propose the following definition which we submit is consistent with clauses approved by the AER in recent decisions.

Tax Change Event means the occurrence of any of the following during the course of an Access Arrangement Period:

(a) a change in a Relevant Tax, in the application or official interpretation of a Relevant Tax, in the rate of a Relevant Tax, or in the way a Relevant Tax is calculated;

(b) the removal of a Relevant Tax; and

(c) the imposition of a Relevant Tax; and

as a consequence, the costs to the Service Provider of providing Reference Services are materially increased or decreased.

2. Access arrangement fixed principle

The AER approved a fixed principle in clause 3.5 of our 2015-20 AA and 2020-2025 AA in relation to cross period cost pass throughs - that is, for cost pass through events that apply in the immediately prior period, but which are passed through via tariffs charged in the subsequent period. Consistent with the AER's previous views on application of this fixed principle we propose to apply this fixed principle only to pass-through from the 2020-25 period.

As the AER noted in its Final Decision in relation to our 2015-20 AA, this fixed principle was:

> *…required to potentially allow the financial impact of an approved cost pass through event that occurs late in one access arrangement period to be addressed in the reference tariffs that apply in the next access arrangement period.*[3]

The AER went on in that Final Decision to approve the fixed principle because it:

- *allows JGN the opportunity to recover its efficient costs should a pass through event occur late in the 2015–20 access arrangement period*
- *provides for consistency between the electricity and gas regulatory regimes, where the same risks and regulatory functions to govern that risk (cost pass throughs) exist.*[4]

The AER also accepted this fixed principle for our 2020-2025 AA and we submit this fixed principle remains necessary in the 2025-30 period for the same reasons as we sought it, and the AER approved it, for the 2015-2020 and 2020-25 periods.

We therefore propose retaining this fixed principle in clause 3.6 of our AA for the 2025-30 period. This would allow pass-through from the 2020-25 period (ie. a cross-period pass-through). Given the AER's previous rejection of a proposal to have this fixed for a number of subsequent AA periods (ie. in this instance beyond the 2025-30 AA period), consistent with that decision we have not sought to extend this fixed principle beyond the 2025-30 AA.

We note also that consistent with the 2020-2025 AA, the fixed principle also specifically references the Automatic Adjustments in Schedule 4 of our 2025-30 AA.[5]

[3] AER, Attachment 11 – Reference tariff variation mechanism | Final decision: Jemena Gas Networks 2015–20, June 2015, page 11-26.

[4] *Ibid*, pages 11-26 to 11-27.

[5] See clause 3.6(c) and (d) of the 2025-30 AA.

Appendix A
Risk Management Framework

A1. Risk Management Framework

A1.1 Options for managing risk

How we manage a particular risk depends upon the options available, and how efficient and effective the options are. 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

Generally, we:

- Avoid risks that present unacceptable risk and would be particularly damaging to the business – we avoid any activity we consider creates an unacceptable health and safety risk to our employees, customers or community.
- Pursue risks where the nature and extent of the changes required to achieve desired performance do not exceed the boundaries of acceptable tolerance for risk – for example, we may introduce new technologies in order to enhance the reliability of the network and those technologies may create some risk.
- Reduce risks by either reducing the likelihood of occurrence or by reducing the impact or consequences should the risk eventuate, including when we consider there is a relatively high chance of an event occurring, but we can mitigate its impact at a relatively low cost – for example, we mitigate the impact of third party hits through our incident 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 third-party insurance to transfer a risk that we are unable to fully mitigate or avoid. The cost pass through mechanism is another example of how risks of uncontrollable and major events are transferred and shared with customers.
- Accept (or self-insure) risks that have a reasonably low probability of occurring and would have a low impact – for example, we may decide that the level of residual risk is acceptable after considering factors such as the adequacy of current controls, the quality and the quality and quantity of information about the controls, the likelihood and consequences of the risk occurring, and the cost of additional controls

Occasionally, we have to share a risk with customers. We do this in various ways, for example via the form of price control adopted and notably the inflation and cost of debt factors that inform price control outcomes. We also share risk via cost pass-through events. 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 where we can. Our nominated cost pass through events are discussed in section 1 above.

A1.2 Our approach to risk management

A1.2.1 Risk management framework

Risk is inherent in every aspect of our Group's business operations. Our Group recognises that effective risk management is fundamental for sound corporate governance and achieving our business objectives.

Understanding the risks we face and managing them appropriately enhances our ability to make better decisions, deliver on objectives and subsequently improve our performance.

Our Group is committed to a proactive and structured approach to risk management. We have established governance forums for risk management and maintain a risk management framework in accordance with AS ISO 31000:2018 Risk Management – Guidelines.

Our Risk Management Manual provides detailed documentation of our risk management process, principles and practices. It serves as a guide for systematically identifying and managing risks across our organisation.

Our reporting and escalation requirements direct risks that have the potential to exceed the Group's risk appetite to be prioritised for attention at the appropriate governance forums.

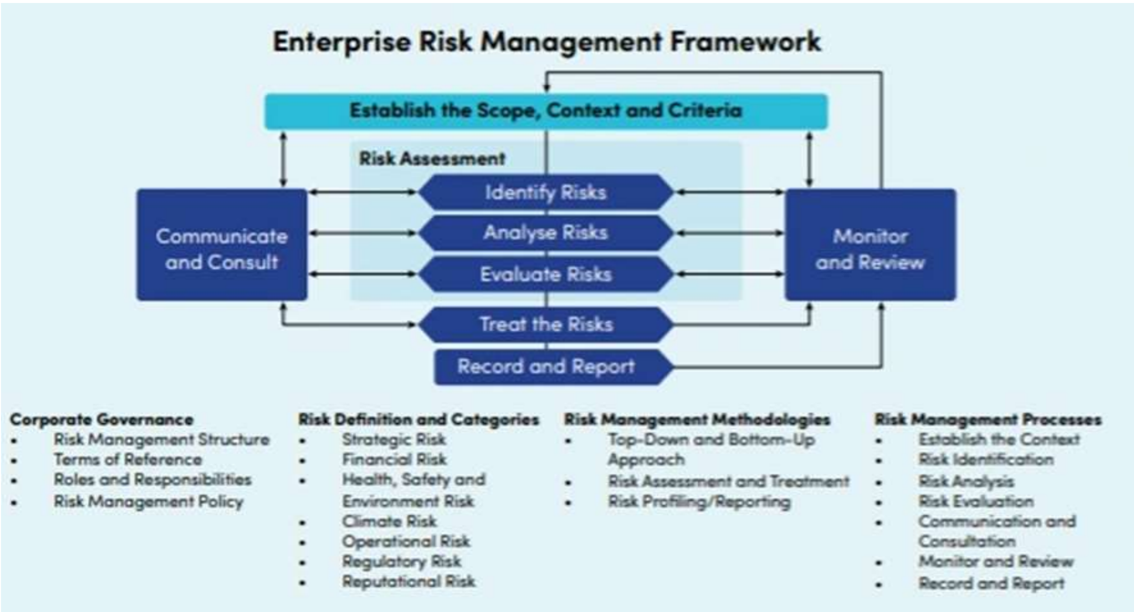
Our governance, risk and compliance system, Omnia, centralises risk data and provides information to support decision-making.

A1.2.2 Our Risk Management Governance Forums

Our risk management governance forums, such as the Board Risk, Health, Safety and Environment Committee (RHSEC) and Executive Risk Management Committee (ERMC), play important roles in overseeing risk management and supporting decision making:

- RHSEC – assists the Board in fulfilling its oversight responsibilities on risk management and the type and level of Group business risks, including sustainability risk.
- ERMC – chaired by the Executive General Manager, People, Safety and Governance, the ERMC supports our Managing Director and the RHSEC in executing their responsibilities.

Our Risk Management Framework



A1.2.3 Risk management process

Our risk management process comprises six key steps:

1. **Scope, Context and Criteria**: Risks within their context, and relationship with the organisational environment and dependencies are identified and understood.
2. **Risk Assessment**: Risks are identified, analysed and evaluated to inform decision-making regarding their management. Our approach includes utilising a Risk Consequence and Likelihood Matrix (below), which guides the prioritisation of risk treatment.
3. **Risk Treatment**: We utilise various risk treatment options including avoidance, reduction, sharing or transfer, and retention or acceptance, depending on the outcomes of risk evaluation.
4. **Communication and Consultation**: Regular and ad-hoc communication, as well as consultation with stakeholders provide a shared understanding of risks, decision-making, and actions taken to manage risks.

5. **Monitoring and Review**: Regular monitoring and review of risks enable us to understand and assess the performance of controls, improve risk treatments, and identify emerging risks in a dynamic business environment.

6. **Recording and Reporting**: We report outcomes of the risk management process to key stakeholders. This enhances risk dialogue and supports stakeholders in their decision-making.

Our Risk Consequence and Likelihood Matrix

LIKELIHOOD	CONSEQUENCE				
	MINOR	SERIOUS	SEVERE	MAJOR	CATASTROPHIC
Almost Certain	Moderate	High	Extreme	Extreme	Extreme
Likely	Moderate	Significant	High	Extreme	Extreme
Possible	Moderate	Moderate	Significant	High	Extreme
Unlikely	Low	Low	Moderate	Significant	High
Rare	Low	Low	Moderate	Moderate	Significant