



# **DRAFT DECISION**

## **Jemena Distribution Determination 2021 to 2026**

### **Attachment 15 Pass through events**

September 2020

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## Note

This attachment forms part of the AER's draft decision on the distribution determination that will apply to Jemena for the 2021–26 regulatory control period. It should be read with all other parts of the draft decision.

The draft decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 11 – Demand management incentive scheme and demand management innovation allowance mechanism

Attachment 12 – Not applicable to this distributor

Attachment 13 – Classification of services

Attachment 14 – Control mechanisms

Attachment 15 – Pass through events

Attachment 16 – Alternative control services

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## 15 Pass through events

During the regulatory control period Jemena can apply to pass through to its customers, in the form of higher or lower network charges, certain material changes in its efficient costs caused by pre-defined exogenous events. These events are called cost pass through events. Such events are limited to circumstances where the business can recover potential costs of defined yet unpredictable high cost events that are outside the control of the business.

The National Electricity Rules (NER) prescribe the following pass through events for all distribution determinations:<sup>1</sup>

- a regulatory change event
- a service standard event
- a tax change event
- a retailer insolvency event.

In addition to these prescribed events, other pass through events may be 'nominated' by a service provider for a regulatory control period.<sup>2</sup> This attachment sets out our draft decision on the nominated pass through events to apply to Jemena's distribution network for the 2021–26 regulatory control period.

### 15.1 Draft decision

Our draft decision is to:<sup>3</sup>

- Accept four of Jemena's proposed nominated pass through events (terrorism, natural disaster, insurer's credit risk and retailer insolvency event).
- Not accept the retailer insolvency event or natural disaster pass through event as drafted by Jemena. Instead the AER substitutes its own definitions of these events, with minor amendments to incorporate new legislative terms and to ensure consistency with our recent decisions for other network service providers.<sup>4</sup>
- Not accept the insurance cap event as drafted by Jemena. Instead we have substituted a new nominated cost pass event, known as the insurance coverage event, in place of Jemena's proposed insurance cap event. This has been done

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<sup>1</sup> NER, cl. 6.6.1(a1)(1)–(4). Each of these prescribed events is defined in Chapter 10 (Glossary) of the NER.

<sup>2</sup> NER, cl. 6.6.1(a1)(5).

<sup>3</sup> NER, cl. 6.12.1(14).

<sup>4</sup> E.g. AER, *Draft Decision, Essential Energy distribution determination 2019–24, Attachment 14 Pass through events*, November 2018, pp. 11–13; AER, *Final Decision, SA Power Networks distribution determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 5–6.

following consultation with Jemena and is consistent with our recent decisions for other network service providers.<sup>5</sup>

- Not accept Jemena’s proposed insurance premium event.

Our reasons are set out in section 15.5 and our cost pass through event definitions in Table 15.2.

## 15.2 Jemena’s proposal

Jemena proposed nominated pass through events are set out in Table 15.1.

**Table 15.1 Jemena’s nominated pass through events**

Pass through event	Jemena proposed definition
Insurance cap	<p>An insurance cap event occurs if:</p> <ul style="list-style-type: none"> <li>a) JEN makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy or program of insurance policies;</li> <li>b) JEN incurs costs beyond the policy limit or otherwise which fall outside the range of cover provided under the relevant insurance policy or program of policies; and</li> <li>c) the costs beyond the policy limit or otherwise outside the range of cover provided under the relevant insurance policy or policies increase the costs to JEN in providing direct control services.</li> </ul> <p>For this Insurance Cap Event:</p> <ul style="list-style-type: none"> <li>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;</li> <li>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;</li> <li>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.</li> </ul> <p>Note in making a determination on an Insurance Cap Event, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> <li>i) the insurance policy or policies for the event</li> </ul>

<sup>5</sup> AER, *Final Decision, Ergon Energy distribution determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 9–10; AER, *Final Decision, Energex distribution determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 9–10.

Pass through event	Jemena proposed definition
	<ul style="list-style-type: none"> <li>ii) the level and range of insurance cover that an efficient and prudent NSP would obtain in respect of the event, and</li> <li>iii) any assessment by the AER of JEN’s insurance in making its distribution determination for the relevant period.</li> </ul>
Insurance premium	<p>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.</p> <p>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.</p> <p>In making a determination on an insurance premium event, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> <li>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</li> <li>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.</li> </ul>

Insurer credit risk	<p>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:</p> <ul style="list-style-type: none"> <li>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</li> <li>b) incurs additional costs associated with funding an insurance claim, which would otherwise have been covered by the insolvent insurer.</li> </ul> <p>Note: In assessing an insurer credit risk event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> <li>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</li> <li>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</li> </ul>
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Pass through event	Jemena proposed definition
	provider.
Natural disaster	<p>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.</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"> <li>a) whether JEN has insurance against the event; and</li> <li>b) the level of insurance that an efficient and prudent service provider would obtain in respect of the event.</li> </ul>
Terrorism	<p>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:</p> <ul style="list-style-type: none"> <li>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</li> <li>b) increases the costs to JEN of providing direct control services.</li> </ul> <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"> <li>i) whether JEN has insurance against the event</li> <li>ii) the level of insurance an efficient and prudent service provider would obtain in respect of the event, and</li> <li>iii) whether a relevant government authority has made a declaration that a terrorism event has occurred.</li> </ul>
Retailer insolvency	<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"> <li>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);</li> </ul>



Pass through event	Jemena proposed definition
	<p>and</p> <p>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> <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.</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>

Source: Jemena, *2021–26 Regulatory proposal – Appendix 07–08 – Managing risk and uncertainty*, February 2020, pp. ix-xix.

### 15.3 Assessment approach

The NER sets out how we must assess nominated pass through events, and how we must assess an application from a service provider to pass through changes in costs where an event occurs.<sup>6</sup>

Our assessment approach is guided by the National Electricity Objective (NEO) and the Revenue and Pricing Principles (RPPs).<sup>7</sup> The RPPs include that the service provider should have a reasonable opportunity to recover at least the efficient costs of providing services and complying with regulatory obligations.<sup>8</sup> The NEO and the RPPs also reflect the importance of incentives to promote economic efficiency,<sup>9</sup> and balance the risks of under and over investment.<sup>10</sup>

In the context of pass through events, we have particular regard to the impact on price, quality, reliability and security of supply that may arise as a result of any change in the efficient operation of, and ability and incentive of, a service provider to invest in its network. This is a similar approach to that taken by the Australian Energy Market Commission (AEMC) when considering pass through event rule changes.<sup>11</sup>

<sup>6</sup> NER, cl. 6.5.10(b), 6.6.1.

<sup>7</sup> NEL, ss. 7 and 7A.

<sup>8</sup> NEL, s. 7A(2).

<sup>9</sup> NEL, s. 7A(3).

<sup>10</sup> NEL, s. 7A(6).

<sup>11</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 6.

In determining whether we accept a nominated pass through event, we must take into account the 'nominated pass through event considerations' as defined, which are as follows:<sup>12</sup>

- 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) (in the case of a distribution determination) or clause 6A.7.3(a1)(1) to (4) (in the case of a transmission determination);
- 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.

The AEMC described the purpose of the nominated pass through event considerations as:

to incorporate and reflect the essential components of a cost pass through regime in the NER. It was intended that in order for appropriate incentives to be maintained, any nominated pass through event should only be accepted when event avoidance, mitigation, commercial insurance and self-insurance are unavailable.<sup>13</sup>

that a pass through event should only be accepted when it is the least inefficient option and event avoidance, mitigation, commercial insurance and self-insurance are found to be inappropriate. That is, it is included after ascertaining the most efficient allocation of risks between a service provider and end customers.<sup>14</sup>

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<sup>12</sup> NER, Chapter 10, definition of nominated pass through event considerations.

<sup>13</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 19.

<sup>14</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 20.

This protects the incentive regime under the NER by limiting erosion of a service provider's incentives to use market based mechanisms to mitigate the cost impacts that would arise.<sup>15</sup> This promotes the efficient investment in, and efficient operation and use of, network services for the long term interests of consumers with respect to price.<sup>16</sup>

As a matter of good regulatory practice, we also take into account the desirability of consistency in our approach to assessing nominated pass through events across our electricity determinations and gas access arrangements.<sup>17</sup>

## 15.4 Interrelationships

The pass through mechanism is not the only way service providers can manage their risks under a distribution or transmission determination. It is interrelated with other parts of this decision, in particular with the forecast operating and capital expenditure (opex and capex) and rate of return included in our revenue determination. We must specify and take account of these interrelationships.<sup>18</sup> This requires us to balance the incentives in the various parts of our decision.

For systemic risks, service providers are compensated through the allowed rate of return. Service providers also face business-specific, or residual, risks. Service providers are compensated for the prudent and efficient management of these risks through the forecast opex and capex we include in our revenue determination for strategies such as:

- prevention (avoiding the risk)
- mitigation (reducing the probability and impact of the risk)
- insurance (transferring the risk to another party)
- self-insurance (putting aside funds to manage the likely costs associated with a risk event).

An efficient business will manage its risk by employing the most cost effective combination of these strategies. In order to maintain appropriate incentives under our determinations, we only accept nominated pass through events where we are satisfied that event avoidance, mitigation, commercial insurance and self-insurance under approved forecasts of prudent and efficient opex and capex are either unavailable or inappropriate.<sup>19</sup>

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<sup>15</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 8.

<sup>16</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 8.

<sup>17</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, p. 18.

<sup>18</sup> NEL, s. 16(1)(c).

<sup>19</sup> AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012, pp. 19–20.

In general, in respect of unforeseen costs that are relatively minor, a service provider should manage them by using up its existing expenditure allowance, or reprioritising or substituting its projects, to avoid seeking cost recovery through the pass through mechanisms.<sup>20</sup> This is reflected in the materiality threshold that applies to cost pass through applications.<sup>21</sup>

Cost pass through amounts approved in a regulatory control period are added to (or in the case of a negative pass through deducted from) forecast opex and capex for the purpose of calculating efficiency carryover amounts under the Efficiency Benefit Sharing Scheme and Capital Expenditure Sharing Scheme.<sup>22</sup>

Any capex that has already been recovered in a regulatory control period by way of a cost pass through cannot be recovered again in the roll-forward of the regulatory asset base for the next regulatory control period.<sup>23</sup>

## 15.5 Reasons for draft decision

### 15.5.1 Insurance cap/coverage, Insurer's credit risk, natural disaster, terrorism and retailer insolvency events

Consistent with our recent determinations for other network service providers,<sup>24</sup> we consider five of Jemena's proposed nominated pass through events (insurance cap, terrorism, natural disaster, insurer's credit risk and retailer insolvency) meet the nominated pass through event considerations set out in the NER:<sup>25</sup>

- the proposed events are not covered by an existing category of pass through event
- the nature of the events are clearly identifiable at this time
- a prudent service provider could not reasonably prevent an event of that nature or type from occurring or substantially mitigate its cost impact, and could not insure (or self-insure) against the events on reasonable commercial terms.

With regard to the latter point, while Jemena could take steps to reduce its risk exposure to these events, expenditure beyond a certain level aimed at completely eliminating the risk is likely to be imprudent or inefficient. In that context, sharing the risk between Jemena and its customers is appropriate and more likely to be in the long-term interests of consumers with respect to price.

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<sup>20</sup> AEMC 2012, *Economic Regulation of Network Service Providers, and Price and Revenue Regulation of Gas Services, Final Position Paper*, 29 November 2012, p. 186.

<sup>21</sup> NER, Chapter 10: Glossary, definition of 'materially'.

<sup>22</sup> AER, *Efficiency Benefit Sharing Scheme for Electricity Network Service Providers*, November 2013, p. 7; AER, *Capital Expenditure Incentive Guideline for Electricity Network Service Providers*, November 2013, p. 6.

<sup>23</sup> NER, cl. S6.2.1(e)(1)(ii).

<sup>24</sup> AER, Final Decision, *SA Power Networks Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 10–15; AER, Final Decision, *Ergon Energy Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 9–10; AER, Final Decision, *Energex Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 9–10.

<sup>25</sup> NER, cl. 6.5.10(b); Chapter 10: Glossary, definition of 'nominated pass through event considerations'.

We have made some minor amendments to the definitions of the retailer insolvency event and natural disaster pass through event to ensure consistency with recent AER decisions for other network service providers, as set out in Table 15.2.

We have also updated the name of the insurance cap pass through event and made some amendments to the definition of that event. This name change - from 'insurance cap event' to 'insurance coverage event' recognises that in the future potential insurance gaps may not only relate to any insurance caps. This change is consistent with recent AER decisions for other network service providers.

Our assessment and decision in relation to these proposed changes is set out below.

### 15.5.1.1 Definition of insurance coverage event.

In proposing its insurance cap event, Jemena modified its existing definition to:<sup>26</sup>

- reflect the layered composition of public liability insurance cover as no single insurance provider will insure against such risk
- clarify 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.

In our recent final SA Power Networks determination for the 2020–25 regulatory control period we considered a similar insurance cap nominated pass through event and made a decision to amend the pass through event definition and rename the event as the insurance coverage event.<sup>27</sup> Following the publication of that determination on 20 June 2020, we consulted with Jemena and have decided to adopt similar changes for this draft decision, including renaming the insurance cap event to the insurance coverage event.<sup>28</sup> This change recognises the volatility in the insurance liability market and the potential for insurance gaps in the future.

Jemena, and other network operators sometimes have more than one policy, particularly for bushfire liability insurance. We consider it appropriate to amend this pass through event to reflect the use of multiple insurance policies. Our amended wording in our definition of insurance coverage event is slightly more generic (and therefore more flexible) than that proposed by Jemena, in that we have made reference to a 'set of insurance policies' instead of 'program of policies'. We consider this change reflects insurance market conditions are changing following significant bushfire events in Australia and overseas. The changes are making bushfire coverage more expensive and difficult to procure.

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<sup>26</sup> Jemena, *2021–26 Regulatory proposal – Appendix 07–08 – Managing risk and uncertainty*, February 2020, p. xiii–xiv.

<sup>27</sup> AER, *Final Decision, SA Power Networks Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, p. 13–14; AER, *Final Decision, Energex Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 9–10; AER, *Final Decision, Ergon Energy Distribution Determination 2020–25 Attachment 14 Pass through events*, June 2020, pp. 9–10.

<sup>28</sup> Jemena, *Information request 48 – Q3*, 22 July 2020, pp. 9–11.

Gaps in a network operator's insurance coverage may occur if Jemena is unable to find suitable insurance providers to fill withdrawn capacity or cannot economically justify higher premiums.

We have refined the pass through definition to allow for unfavourable changes to Jemena's insurance policy, but only under what we have defined as 'changed circumstances'. While Jemena's proposal included a different definition which proposed to cover those costs which fall 'outside the range of cover', we consider our definition of 'changed circumstances' addresses the same core issues with a balanced approach. The definition of 'changed circumstances' is as follows:

'changed circumstances' means movements in the relevant insurance liability market that are beyond the control of Jemena, where those movements mean that it is no longer possible for Jemena 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 2<sup>29</sup> within the scope of that insurance policy or set of insurance policies.

Our draft decision recognises, in general, the possibility of future coverage gaps, negative impact on deductible schedules or reinstatement rights faced by network service providers in the prevailing insurance market, but also seeks to preserve appropriate pass through event incentives under a normal operating environment.

As part of its response to an information request on the insurance step change, Jemena stated that, for the most part, it considers the approach adopted in the Final Decision of SA Power Networks' Distribution Determination 2020–25<sup>30</sup> as a workable model to address the new challenges presented to distribution business through changes in the insurance market.<sup>31</sup> Jemena also proposed minor drafting changes to insurance coverage event definition<sup>32</sup>.

We have not considered Jemena's specific drafting changes as part of our draft decision for all the Victorian distribution businesses. Rather, we consider it more appropriate to first get feedback from all Victorian distributors in their revised proposals on our draft decision insurance coverage pass through event definition. This will ensure we have a consistent definition across all the Victorian distributors and considered their collective views for our final decision. We would also welcome the views of other Victorian distributors on to the relevance and merits of the Jemena's proposed amendments to the insurance coverage pass through event.

As foreshadowed in our recent decisions, we consider it reasonable to provide Jemena and the broader industry with greater clarity and guidance around the matters we are likely to have regard to in assessing any insurance coverage pass through event that occurs. Any residual concerns that Jemena might have can be addressed through this

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<sup>29</sup> See Table 15.2 of this Attachment, paragraph 2, under the insurance coverage pass through event definition.

<sup>30</sup> AER, *Final Decision, SA Power Networks Distribution Determination 2020–25, Attachment 14, Pass through events*, June 2020, pp. 13–14.

<sup>31</sup> Jemena, *Response to Information request 048 – Q3*, 22 July 2020, p. 9–11.

<sup>32</sup> Jemena, *Response to Information request 048 – Q3*, 22 July 2020, p. 9–11.

process.<sup>33</sup> We released a consultation paper on 28 August 2020<sup>34</sup> seeking stakeholder views on the key elements that will guide our assessment of an insurance coverage pass through event application. This will be used to assist us to develop a draft and final guidance note. We welcome submissions by 30 October 2020.

### 15.5.1.2 Definition of retailer insolvency event

We have amended the retailer insolvency pass through definition in order to clarify the meaning of the terms 'retailer insolvency costs', 'failed retailer' and 'billed but unpaid charges' are consistent with the NER.

This change was a result of other service providers raising that these terms have been incorporated into the NER as a result of the National Electricity Amendment (Retailer-Distributor Credit Support Requirements) Rule 2017.<sup>35</sup>

The change in definition should have no material impact on the operation of the pass through event.

### 15.5.1.3 Definition of natural disaster event

In its proposal, Jemena proposed an amendment to the natural disaster event definition to include the word 'unlawful' before the words '...acts or omissions.'

Jemena state that the aim of this amendment is to 'preserve the availability of the event if a natural disaster (such as fire) arises as a consequence of Jemena acting (or not acting) in adherence to its regulatory requirements.'<sup>36</sup>

This would cover circumstances where Jemena believe that compliance with these regulations could prevent it from meeting pass through requirements. Jemena submitted that it is necessary that the 'acts or omissions' of Jemena that are excluded from triggering the pass through event be qualified so that such lawful acts (and omissions) do not unfairly disadvantage Jemena. It provided an example, in the context of vegetation clearance, to illustrate that there may be circumstances in which Jemena is prohibited from clearing vegetation, even though contact between that vegetation and the distribution infrastructure could provide a source of ignition for a bushfire start.

While we recognise the specific scenario outlined by Jemena, we do not consider adding the word 'unlawful' as the appropriate solution, as it would broaden the scope of the pass through event considerably. Our decision is to amend the definition to specify that act or omissions includes those 'necessary for the service provider to comply with

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<sup>33</sup> Jemena, *Response to Information request 048 – Q3*, 22 July 2020, p. 9.

<sup>34</sup> See <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/insurance-coverage-pass-through-event-%E2%80%93-guidance-note>.

<sup>35</sup> Powercor, *2021–26 Regulatory proposal – Supporting document PAL APP04 – Managing uncertainty – appendix*, January 2020, p. 17; CitiPower, *2021–26 Regulatory proposal – Supporting document CP APP04 – Managing uncertainty – appendix*, January 2020, p.17; United Energy, *2021–26 Regulatory proposal – Appendix 4 – Uncertainty appendix*, January 2020, p.17.

<sup>36</sup> Jemena, *2021–26 Regulatory proposal – Appendix 07–08 – Managing risk and uncertainty*, February 2020, p. x.



a regulatory obligation or requirement or with an applicable regulatory instrument'. This addresses Jemena's concerns in a more targeted way and is consistent with previous AER determinations.<sup>37</sup> We believe this change sufficiently covers the example illustrated by Jemena and similar events.

### 15.5.2 Insurance premium event

We do not accept Jemena's proposed insurance premium event because we are not satisfied that it meets the nominated pass through considerations under the NER.

Jemena proposed an insurance premium event to address the risk of significant increases in insurance premiums arising from events outside of Jemena's control.<sup>38</sup> It referred to the prevailing limited capacity and highly volatile global liability insurance market as the main driver for paying greater premiums in the future.<sup>39</sup> It claimed that it is especially vulnerable to the premium increases due to the relatively small size of its electricity network, and having a large proportion of its distribution areas exposed to bushfire risks.<sup>40</sup> It also argued that the proposed insurance premium event remains appropriate despite seeking an insurance premium step change in parallel because that step change does not factor in any major insurance market volatility occurring in the future that may expose Jemena to further premium increases and reductions of insurer capacity beyond those forecast in our step change.<sup>41</sup>

In our recent decisions<sup>42</sup>, we noted the volatility in the insurance liability market and took account of this impact on network providers by including an insurance coverage event. As discussed above (section 15.5.1.1), we have accepted the insurance coverage event and are of the view that it addresses key aspects of the unusual and uncontrollable risks faced by Jemena in the prevailing insurance liability market. The appropriate regulatory mechanisms used to allow a network services provider to recover costs is important in order not to duplicate recovery for the same set of risks as well as placing maximum incentives for that network services provider to address the identified risks and incur efficient costs.

Where a network provider seeks a separate step change for the increasing insurance premiums, we consider it on its merits. Unlike other Victorian distribution network services providers, Jemena sought a step change for increasing insurance premiums in addition to an insurance premium pass through event. This is considered separately in Attachment 6 of this draft decision. In considering whether to allow an insurance premium event, we were not assisted by the level of substantiation by Jemena about

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<sup>37</sup> AER, *Final Decision, SA Power Networks Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 10–11.

<sup>38</sup> Jemena, *2021–26 Regulatory proposal – Appendix 07–08 – Managing risk and uncertainty*, February 2020, p.xiii,

<sup>39</sup> Jemena, *2021–26 Regulatory proposal – Appendix 07–08 – Managing risk and uncertainty*, February 2020, p.xviii,

<sup>40</sup> Jemena, *2021–26 Regulatory proposal – Appendix 07–08 – Managing risk and uncertainty*, February 2020, p.xviii,

<sup>41</sup> Jemena, *2021–26 Regulatory proposal – Appendix 07–08 – Managing risk and uncertainty*, February 2020, p.xviii,

<sup>42</sup> AER, *Final Decision, SA Power Networks Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 13–14; AER, *Final Decision, Ergon Energy Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 9–10; AER, *Final Decision, Energex Distribution Determination 2020–25, Attachment 14 Pass through events*, June 2020, pp. 9–10.



the additional risks and the likely higher insurance costs that it would face in the future. In response to an information request, Jemena stated that it does not foresee any additional expenditures above the insurance premiums other than administration costs.<sup>43</sup>

Given that Jemena has not provided further information on any additional risks or costs beyond the 2021–26 regulatory control period, over and above those already identified in a separate step change, we do not accept the nominated pass through event proposed by Jemena. Pass through events should be limited to unpredictable, infrequent and high cost events that are beyond the control of the network services provider - we are not able to form this conclusion based on the information provided by Jemena on the need for an insurance premium pass through event.

Accordingly, we do not accept the insurance premium pass through nominated by Jemena in its regulatory proposal.

Table 15.2 summarises the nominated pass through events accepted by us in the draft decision.

**Table 15.2 AER pass through event definitions**

Pass through event	Approved definition
Insurance coverage	<p>An insurance coverage event occurs if:</p> <ol style="list-style-type: none"> <li>1. Jemena:               <ol style="list-style-type: none"> <li>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</li> <li>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</li> </ol> </li> <li>2. Jemena incurs costs:               <ol style="list-style-type: none"> <li>a) beyond a relevant policy limit for that policy or set of insurance policies; or</li> <li>b) that are unrecoverable under that policy or set of insurance policies due to changed circumstances; and</li> </ol> </li> <li>3. The costs referred to in paragraph 2 above materially increase the costs to Jemena in providing direct control services.</li> </ol> <p>For the purposes of this insurance coverage event:</p> <p>'changed circumstances' means movements in the relevant insurance liability market that are beyond the control of Jemena, where those movements mean that it is no longer possible for Jemena to take out an insurance policy or set</p>

<sup>43</sup> Jemena, *Response to Information request 48 – Q4*, 22 July 2020, p. 12.

Pass through event	Approved definition
	<p>of insurance policies at all or on reasonable commercial terms that include some or all of the costs referred to in paragraph 2 above within the scope of that insurance policy or set of insurance policies.</p> <p>'costs' means the costs that would have been recovered under the insurance policy or set of insurance policies had:</p> <ul style="list-style-type: none"> <li>i. the limit not been exhausted; or</li> <li>ii. those costs not been unrecoverable due to changed circumstances.</li> </ul> <p>A relevant insurance policy or set of insurance policies is an insurance policy or set of insurance policies held during the regulatory control period or a previous regulatory control period in which Jemena was regulated; and</p> <p>Jemena will be deemed to have made a claim on a relevant insurance policy or set of insurance policies if the claim is made by a related party of Jemena in relation to any aspect of Jemena's network or business; and</p> <p>Jemena will be deemed to have been able to make a claim on a relevant insurance policy or set of insurance policies if, but for changed circumstances, the claim could have been made by a related party of Jemena in relation to any aspect of Jemena's network or business.</p> <p>Note for the avoidance of doubt, in assessing an insurance coverage event through application under rule 6.6.1(j), the AER will have regard to:</p> <ul style="list-style-type: none"> <li>i, the relevant insurance policy or set of insurance policies for the event</li> <li>ii. the level of insurance that an efficient and prudent DNSP would obtain, or would have sought to obtain, in respect of the event; and</li> <li>iii. any information provided by Jemena to the AER about Jemena's actions and processes.</li> </ul>
Insurer credit risk	<p>An insurer credit risk event occurs if an insurer of Jemena becomes insolvent, and as a result, in respect of an existing or potential claim for a risk that was insured by the insolvent insurer, Jemena:</p> <ul style="list-style-type: none"> <li>(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</li> <li>(b) incurs additional costs associated with funding an insurance claim, which would otherwise have been covered</li> </ul>

Pass through event	Approved definition
	<p>by the insolvent insurer.</p> <p>Note: in assessing an insurer credit risk event pass through application, the AER will have regard to, amongst other things:</p> <ul style="list-style-type: none"> <li>i. Jemena’s attempts to mitigate and prevent the event from occurring by reviewing and considering the insurer’s track record, size, credit rating and reputation, and</li> <li>ii. in the event that a claim would have been covered by the insolvent insurer’s policy, whether Jemena had reasonable opportunity to insure the risk with a different provider</li> </ul>
Natural disaster	<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 Jemena in providing direct control services, provided the fire, flood or other event was:</p> <ul style="list-style-type: none"> <li>(a) a consequence of an act or omission that was necessary for the service provider to comply with a regulatory obligation or requirement or with an applicable regulatory instrument; or</li> <li>(b) not a consequence of any other act or omission of the service provider.</li> </ul> <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"> <li>(1) whether Jemena has insurance against the event,</li> <li>(2) the level of insurance that an efficient and prudent NSP would obtain in respect of the event.</li> </ul>
Terrorism	<p>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:</p> <ul style="list-style-type: none"> <li>(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</li> <li>(b) increases the costs to Jemena in providing direct control services.</li> </ul> <p>Note: In assessing a terrorism event pass through application, the AER will have regard to, amongst other</p>

Pass through event	Approved definition
Retailer insolvency	<p>things:</p> <ul style="list-style-type: none"> <li>i. whether Jemena has insurance against the event</li> <li>ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event, and</li> <li>iii. whether a declaration has been made by a relevant government authority that a terrorism event has occurred.</li> </ul> <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> <p>(a) where used in the definition of 'retailer insolvency event' in the NER, the term 'retailer' means the holder of a licence to sell electricity under the Electricity Industry Act 2000 (Vic); and</p> <p>(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> <p>For the purposes of this definition, the terms 'eligible pass through amount' and 'positive change event' where they appear in the NER (as well as any subordinate terms including, without limitation, 'retailer insolvency costs', 'failed retailer' and 'billed but unpaid charges') are modified in respect of this retailer insolvency event in the same manner as those terms are modified in respect of the retailer insolvency event prescribed in the NER from time to time.</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>

Source: AER analysis

## Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
capex	capital expenditure
CCP 17	Consumer Challenge Panel, sub-panel 17
distributor / DNSP	distribution network service provider
ECA	Energy Consumers Australia
EV	electric vehicle
ICT	information and communications technology
NEL	National Electricity Law
NEO	National Electricity Objective
NER	National Electricity Rules
NSP	network service provider
opex	operating expenditure
RPP	revenue and pricing principles