



**PRELIMINARY DECISION**  
**Jemena distribution**  
**determination**  
**2016 to 2020**

**Attachment 15 – Pass through**  
**events**

October 2015

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Inquiries about this publication should be addressed to:

Australian Energy Regulator  
GPO Box 520  
Melbourne Vic 3001

Tel: (03) 9290 1444

Fax: (03) 9290 1457

Email: [AERInquiry@aer.gov.au](mailto:AERInquiry@aer.gov.au)

## Note

This attachment forms part of the AER's preliminary decision on Jemena's revenue proposal 2016–20. It should be read with all other parts of the preliminary decision.

The preliminary decision includes the following documents:

Overview

Attachment 1 - Annual revenue requirement

Attachment 2 - Regulatory asset base

Attachment 3 - Rate of return

Attachment 4 - Value of imputation credits

Attachment 5 - Regulatory depreciation

Attachment 6 - Capital expenditure

Attachment 7 - Operating expenditure

Attachment 8 - Corporate income tax

Attachment 9 - Efficiency benefit sharing scheme

Attachment 10 - Capital expenditure sharing scheme

Attachment 11 - Service target performance incentive scheme

Attachment 12 - Demand management incentive scheme

Attachment 13 - Classification of services

Attachment 14 - Control mechanism

Attachment 15 - Pass through events

Attachment 16 - Alternative control services

Attachment 17 - Negotiated services framework and criteria

Attachment 18 - f-factor scheme

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## Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AMI	Advanced metering infrastructure
augex	augmentation expenditure
capex	capital expenditure
CCP	Consumer Challenge Panel
CESS	capital expenditure sharing scheme
CPI	consumer price index
DRP	debt risk premium
DMIA	demand management innovation allowance
DMIS	demand management incentive scheme
distributor	distribution network service provider
DUoS	distribution use of system
EBSS	efficiency benefit sharing scheme
ERP	equity risk premium
Expenditure Assessment Guideline	Expenditure Forecast Assessment Guideline for electricity distribution
F&A	framework and approach
MRP	market risk premium
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider
opex	operating expenditure
PPI	partial performance indicators
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
repex	replacement expenditure

Shortened form	Extended form
RFM	roll forward model
RIN	regulatory information notice
RPP	revenue and pricing principles
SAIDI	system average interruption duration index
SAIFI	system average interruption frequency index
SLCAPM	Sharpe-Lintner capital asset pricing model
STPIS	service target performance incentive scheme
WACC	weighted average cost of capital

## 15 Pass through events

The pass through mechanism of the NER recognises a 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 (or pass through) the costs of defined unpredictable, high cost events not built into our distribution determination. The NER includes the following prescribed pass through events for all distributors:

- a regulatory change event
- a service standard event
- a tax change event
- a retailer insolvency event.<sup>1</sup>

In addition to the above (prescribed) events, an event may be specified in a determination for a regulatory control period (nominated pass through event).<sup>2</sup>

This attachment sets out our preliminary decision on the additional pass through events for Jemena during the 2016–20 regulatory control period.

### 15.1 Preliminary decision

We do not approve the following nominated pass through events as put to us by Jemena, but our preliminary decision includes alternative definitions for these events:

- insurance cap event
- insurer's credit risk event
- natural disaster event
- terrorism event
- retailer insolvency event.

We do not approve the following events proposed by Jemena:

- end of metering derogation event
- carbon cost event.

We approve application of the NER pass through provisions to alternative control services, as proposed by Jemena.

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<sup>1</sup> Note, this is only a prescribed event in jurisdictions where the National Energy Customer Framework has commenced, and therefore does not apply in Victoria.

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

## 15.2 Jemena's proposal

Jemena proposed seven nominated pass through events for the 2016–21 regulatory control period in addition to the events prescribed in the NER.<sup>3</sup> These are set out in Table 15-1.<sup>4</sup> Jemena also proposed that the NER pass through provisions be applied to its alternative control services in addition to standard control services.

**Table 15-1 Jemena's proposed pass through events**

Proposed event	Jemena's proposed definition
Insurance cap event	<p>“An event where:</p> <p>(a) the DNSP makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy;</p> <p>(b) the DNSP incurs costs beyond the relevant policy limit; and</p> <p>(c) the costs beyond the relevant policy limit increase the costs to the DNSP of providing direct control services.</p> <p>For this Insurance Cap Eve</p> <p>(a) the relevant policy limit is the greater of:</p> <p>i. the DNSP’s actual policy limit at the time of the event that gives, or would have given rise to the claim; and</p> <p>ii. the policy limit that is explicitly or implicitly commensurate with the allowance for insurance premiums that is included in the forecast operating expenditure allowance approved in the AER’s final decision for the regulatory control period in which the relevant insurance policy is issued;</p> <p>(b) a relevant insurance policy is an insurance policy held during the regulatory control period or a previous regulatory control period; and</p> <p>(c) the DNSP will be deemed to have made a claim on a relevant insurance policy if the claim is made by a related party of the DNSP in relation to any aspect of the DNSP’s distribution network or the DNSP’s business.”</p>
Insurer credit risk event	<p>“The insolvency of the DNSP’s insurer, as a result of which the DNSP:</p> <p>(a) incurs higher or lower costs for insurance premiums than those allowed for in the distribution determination;</p> <p>(b) in respect of a claim for a risk that would have been insured by the DNSP’s insurers, is subject to materially higher or lower claim limit, or a materially higher or lower deductible than would have applied under that policy; or</p> <p>(c) incurs additional costs associated with self-funding an insurance claim, which, would have otherwise been covered by the insolvent insurer.”</p>
Natural disaster event	<p>“Any fire, flood, earthquake, or other natural disaster that occurs during the forthcoming regulatory control period and increases the costs to the DNSP of providing direct control services.”</p>
Terrorism event	<p>“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 from its nature or context is done</p>

<sup>3</sup> Jemena Electricity Networks (Vic) Ltd, *Regulatory Proposal*, April 2015, Attachment 5-4, p. 1.

<sup>4</sup> Jemena Electricity Networks (Vic) Ltd, *Regulatory Proposal*, April 2015, p. 45.



Proposed event	Jemena's proposed definition
	<p>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 which increases the costs to the DNSP in providing direct control services, to the extent those costs are not recovered from a third party.”</p>
Retailer insolvency event	<p>“The failure of a retailer during the regulatory control period to pay the DNSP an amount to which the DNSP is entitled for the provision of direct control services, if:</p> <p>(a) an insolvency official has been appointed in respect of that retailer; and</p> <p>(b) the DNSP is not entitled to payment of that amount in full under the terms of any credit support provided in respect of that retailer, and as a result of which the DNSP incurs, or will incur costs.</p> <p>For this retailer insolvency event, the costs the DNSP incurs, or will incur, are all amounts that the DNSP is entitled to be paid (but which are or will be unpaid as a result of a retailer insolvency event) for the provision of direct control services.”</p>
End of metering derogation event	<p>“An end of the metering derogation event occurs if, as a result of the impending or actual expiry of the Victorian Metering Derogation, the DNSP incurs, or will incur, costs to facilitate the introduction of metering contestability (whether prior to, or subsequent to the expiry of that Derogation) including, but not limited to:</p> <p>(a) system costs for establishing metering contestability;</p> <p>(b) meter provider of last resort costs; and</p> <p>(c) costs incurred to obtain non-metrology data from meters to enable the distributor to operate its network.</p> <p>For this end of the metering derogation event, the Victorian Metering Derogation is the derogation currently provided for in clause 9.9C of the Rules pursuant to the National Electricity Amendment (Victorian Jurisdictional Derogation – Advanced Metering infrastructure) Rule 2013 and any subsequent derogation which may be made with similar effect to that in clause 9.9C of the Rules but with a different expiry date.”</p>
Carbon cost event	<p>“The imposition of obligations under any Carbon Scheme, including without limitation the imposition of any charges or fees payable in respect of greenhouse gas emissions, costs of acquiring permits, allowances, credits, or certificates, costs associated with undertaking activities to abate or sequester greenhouse gas emissions and costs associated with reducing liability under any Carbon Scheme.</p> <p>Carbon Scheme means any law or regulation of the Commonwealth of Australia or of a State or Territory of Australia, with respect to the production or emission of, or to reduce, limit, cease, prevent, offset, remove or sequester greenhouse gas emissions.”</p>

Source: Jemena Electricity Networks (Vic) Ltd, *Regulatory Proposal 1 January 2016 - 31 December 2020*, April 2015, Attachment 5-4, pp. 7–16.

## 15.3 AER's assessment approach

We must decide which of Jemena's proposed nominated pass through events will apply for the 2016–20 regulatory control period. Pass through events transfer financial risks from the distributors to consumers. If one of the nominated events occurs, the costs of the event that we assess as meeting the factors set out in the NER are passed through to consumers and network charges increase.<sup>5</sup>

<sup>5</sup> NER, cl. 6.6.1(d),(g) and (j).

Our approach has been guided by the National Electricity Objective (NEO) and the Revenue and Pricing Principles. These provide the distributor with a reasonable opportunity to recover at least the efficient costs incurred in providing services.<sup>6</sup> They also provide incentives to promote economic efficiency.<sup>7</sup> Together, they promote a balance between the economic costs and risk management to promote efficient investment.<sup>8</sup>

The NER include the following nominated pass through event considerations which we must have regard to when assessing nominated pass through events.<sup>9</sup>

The nominated pass through event considerations are:

(a) 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);

(b) whether the nature or type of event can be clearly identified at the time the determination is made for the service provider;

(c) 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;

(d) whether the relevant service provider could insure against the event, having regard to:

(1) the availability (including the extent of availability in terms of liability limits) of insurance against the event on reasonable commercial terms; or

(2) whether the event can be self-insured on the basis that:

(i) it is possible to calculate the self-insurance premium; and

(ii) 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.

(e) any other matter the AER considers relevant and which the AER has notified Network Service Providers is a nominated pass through event consideration.<sup>10</sup>

These considerations involve an assessment of the incentives for distributors to manage their risks efficiently.

For systemic risks, distributors are compensated through the allowed rate of return. Distributors also face business-specific, or residual, risks. These activities are

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<sup>6</sup> NEL, s. 7A(2).

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

<sup>8</sup> NEL, s. 7A(6).

<sup>9</sup> NER, cl. 6.5.10(b); NER glossary, definition of 'nominated pass through event considerations'.

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

generally compensated through the opex and capex allowances. Beyond this, a distributor may manage other risks through a number of other strategies, including:

- prevention (avoiding the risk)
- mitigation (reducing the negative effect or probability 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. For example, if a cost is reasonably predictable a business should factor it into its proposed opex and capex. In addition, a distributor may invest in its networks to mitigate the impact of certain events occurring. Alternatively, if the probability of events occurring can be readily estimated then the event should be insurable.

Pass through events cover those limited circumstances for which the risks cannot be managed efficiently in these ways and for which the distributor should be able to recover its efficient costs.

A factor for us to consider, which is reflected in the pass through event considerations, is who is best placed to manage a given risk. Generally, the party in the best position to manage a risk should bear the risk of that event occurring. If the distributor, or customers, are fully exposed to a risk, this may lead to adverse outcomes.

For example, where it is not possible for a distributor to insure against a risk, a distributor may need to share that risk with customers to ensure the service may continue should the event occur. The uninsurable risk may also be outside the control of the distributor and have a low probability of occurring, but a significant cost impact when it does occur. The most efficient and prudent solution to manage that type of risk may be to require customers to accept some of the burden of that risk, by allowing a pass through in the unlikely event that the risk eventuates.

On the other hand, if the distributor is able to pass through all the costs of such an event, its incentive to take prudent actions to prevent or mitigate the potential cost impact of the risk may be weakened. Accordingly, while customers may need to accept some of the burden of the risk, the distributor will need to share some of the risk too. That might be achieved, for example, by making a pass through conditional on the distributor demonstrating it has acted prudently and efficiently in managing the potential impact of the event.

We consider all of these issues when assessing a nominated pass through event with the aim of achieving the right balance, in the long term interests of consumers, in accordance with the nominated pass through event considerations.

As a matter of good regulatory practice, an additional factor we take into account is consistency in our approach to assessing nominated pass through events across our determinations.

### 15.3.1 Interrelationships

As we mentioned above, pass through events are not the only mechanism in this determination by which Jemena can manage its risks. The nominated pass through events are interrelated with other parts of this determination, in particular with the proposed opex and capex allowances and the rate of return. These interrelationships require us to balance the incentives in the various parts of our decision.

## 15.4 Reasons for preliminary decision

In this section we set out the reasons for our preliminary decisions on each of Jemena's proposed pass through events. We have:

- accepted Jemena's proposal to apply the NER pass through provisions to alternative control services
- not accepted Jemena's proposed definitions for the insurance event, insurer credit risk event, natural disaster event, terrorism event and retailer insolvency event, and substituted alternative definitions
- not accepted the end of metering derogation event or carbon cost event.

### 15.4.1 Pass throughs and alternative control services

We approve Jemena's proposal that nominated pass through events refer to 'direct control services'. This means that Jemena may apply to pass through an increase (or decrease) in costs incurred in providing both standard and alternative control services. This is consistent with the prescribed pass through event definitions set out in the NER, which also reference direct control services.

### 15.4.2 Insurance cap event

The insurance cap event would allow Jemena to recover material costs incurred which exceed its insurance claim policy limit. We accept that an insurance cap event can be consistent with the nominated pass through considerations, if appropriately defined. We do not accept Jemena's proposed definition. We have amended the proposed definition to incorporate factors we will have regard to when assessing a claim for a pass through.

The NER list a number of factors to which we must have regard in making a determination on a pass through application, including any factors the AER considers relevant.<sup>11</sup> We consider including additional factors we consider relevant to a nominated pass through event provides greater certainty and transparency in the operation of nominated pass through events. This supports the NER nominated pass

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<sup>11</sup> NER, cl. 6.6.1(j)(8).

through considerations, which require that events themselves can be clearly identified at the time of our determination.<sup>12</sup>

We accept that the insurance cap event would protect Jemena from high cost impact events which would be uneconomical to insure against. We consider consumers benefit because they are not required to fund excessive premiums where insurance, if available, would be uneconomic. Consumers then only bear the risk should an insurance cap event occur.

We note that if a pass through event of this type were to occur, in assessing Jemena's application to pass through costs we will consider the efficiency of Jemena's decisions and actions. We would consider whether it failed to take reasonable action to reduce the magnitude of the amount being claimed and whether any act or omission it took in response to the event increased the magnitude of the amount claimed.<sup>13</sup> This gives Jemena an incentive to mitigate the risks associated with the event including through acquiring an appropriate level of insurance and implementing other practical risk minimisation strategies in its operations.

Our revised definition is set out below:

An insurance cap event occurs if:

1. Jemena makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy,
2. Jemena incurs costs beyond the relevant policy limit, and
3. the costs beyond the relevant policy limit materially increase the costs to Jemena in providing direct control services.

For this insurance cap event:

4. the relevant policy limit is the greater of:
  - a. Jemena's actual policy limit at the time of the event that gives, or would have given rise to a claim, and
  - b. the policy limit that is explicitly or implicitly commensurate with the allowance for insurance premiums that is included in the forecast operating expenditure allowance approved in the AER's final decision for the regulatory control period in which the insurance policy is issued.
5. A relevant insurance policy is an insurance policy held during the 2016–20 regulatory control period or a previous regulatory control period in which Jemena was regulated.

Note for the avoidance of doubt, in assessing an insurance cap event cost pass through application under rule 6.6.1(j), the AER will have regard to:

- i. the relevant insurance policy for the event, and

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<sup>12</sup> NER, cl. 6.5.10(b); NER glossary, definition of 'nominated pass through event considerations', paragraph (b).

<sup>13</sup> NER, cl. 6.6.1(j)(3).

- ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event.

### 15.4.3 Insurer credit risk event

Jemena's proposed insurer credit risk event would allow it to pass through costs if an insurer becomes insolvent and Jemena is subject to higher or lower premiums, or a higher or lower claims limit or deductible. We accept an insurer credit risk event can be consistent with the nominated pass through considerations, if appropriately defined. We do not accept Jemena's proposed definition. We note Jemena:

- contracts an insurance broker that monitors the credit ratings and financial capabilities of insurance providers
- only obtains insurance from an insurer with a minimum A- credit rating, and monitors S&P ratings movements
- obtains quarterly insurer security rating reports from its brokers in relation to credit rating and reputation
- highlighted the unforeseen collapse of HIH Insurance in 2001 and AIG Insurance's difficulties in 2009
- takes a number of other steps to mitigate an insurer's credit risk event.<sup>14</sup>

A NSP may suffer a significant loss as a consequence of an insurer becoming insolvent and thereby being unable to satisfy all insurance claims. NSPs are limited in the extent to which they can avoid losses, short of taking out multiple insurance policies to cover the same risks. We accept the options available to NSPs to manage these risks are limited and, given the rarity of such events, may in fact result in greater expenditure on insurance than is prudent or efficient.

However, Jemena's proposed insurer credit risk event is broader in two respects than that we have approved in recent decisions.

First, in its proposed definition for this event, Jemena sought to include provision for it to pass through costs associated with changes to insurance premiums as a result of an insurer becoming insolvent. As noted in section 15.3, above, a factor for us to consider, which is reflected in the pass through event considerations, is who is best placed to manage a given risk. Generally, the party in the best position to manage a risk should bear the risk of that event occurring. We consider insurance premiums are a typical business expense, subject to ordinary market factors in the economy. This is a risk businesses are best placed to manage, rather than customers. This view is consistent with our approach in recent decisions. Our substitute definition therefore does not allow Jemena to pass through higher or lower costs for insurance premiums as a result of the failure of an insurer.

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<sup>14</sup> Jemena Electricity Networks (Vic) Ltd, *Regulatory Proposal 1 January 2016 - 31 December 2020*, April 2015, Attachment 5-4, p. 10.

Second, the nominated pass through considerations require us to consider whether a prudent service provider could reasonably prevent an event from occurring or substantially mitigate the cost impact of such an event.<sup>15</sup> We must also consider 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.<sup>16</sup> Our substitute definition addresses these considerations by limiting the insurer credit risk event to costs specific to existing or potential claims to the failed insurer. In this way, Jemena does not have the incentive to delay the purchase of alternative insurance, thereby transferring the risk of insurable events to customers.<sup>17</sup>

The NER list a number of relevant factors to which we must have regard in making a determination on a pass through application, including any factors the AER considers relevant.<sup>18</sup> As discussed above, we consider including additional factors we consider relevant to a nominated pass through event provides greater transparency in the operation of nominated pass through events and supports the nominated pass through event considerations.<sup>19</sup> Our substitute definition explicitly clarifies that Jemena's attempts to mitigate or prevent the event from occurring<sup>20</sup>, and whether it had a reasonable opportunity to obtain alternative insurance<sup>21</sup>, are relevant to this assessment.

We consider amendments to Jemena's proposed definition will more clearly define the event, consistent with the nominated pass through event considerations. Our amended definition improves the event description<sup>22</sup> and account for whether Jemena could mitigate the cost impact of the event<sup>23</sup> or procure replacement insurance<sup>24</sup>. Hence, we propose an amended definition:

An insurer's credit risk event occurs if:

A nominated insurer of Jemena 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, Jemena:

- 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
- incurs additional costs associated with funding an insurance claim, which would otherwise have been covered by the insolvent insurer.

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<sup>15</sup> NER glossary, definition of 'nominated pass through event considerations', (c).

<sup>16</sup> NER glossary, definition of 'nominated pass through event considerations', (d).

<sup>17</sup> NER glossary, definition of 'nominated pass through event considerations' (c), (d).

<sup>18</sup> NER, cl. 6.6.1(j)(8).

<sup>19</sup> NER glossary, definition of 'nominated pass through event considerations', (b).

<sup>20</sup> NER glossary, definition of 'nominated pass through event considerations', (c).

<sup>21</sup> NER glossary, definition of 'nominated pass through event considerations', (d).

<sup>22</sup> NER, cl. 6.5.10(b); NER glossary, definition of 'nominated pass through event considerations', paragraph (b).

<sup>23</sup> NER, cl. 6.5.10(b); NER glossary, definition of 'nominated pass through event considerations', paragraph (c).

<sup>24</sup> NER, cl. 6.5.10(b); NER glossary, definition of 'nominated pass through event considerations', paragraph (d).

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

- 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.
- In the event that a claim would have been made after the insurance provider became insolvent, whether Jemena had reasonable opportunity to insure the risk with a different provider.

#### 15.4.4 Natural disaster event

This event will allow Jemena to pass through costs associated with natural disasters. We accept that a natural disaster event can be consistent with the nominated pass through considerations, if appropriately defined. In its proposal Jemena outlined measures to mitigate the cost impact of natural disasters through its 'organisational resilience framework and associated plans'.<sup>25</sup> We do not accept the proposed definition because it does not sufficiently reflect the extent to which a provider could mitigate the cost impact of the event<sup>26</sup> and whether the provider could insure against the event.<sup>27</sup>

To this end, we have amended Jemena's proposed definition to reflect factors we will have regard to when assessing a claim for pass through. We have also amended the definition to refer to 'major' natural disasters. This better reflects the requirements of the nominated pass through event considerations by making clearer when the event will be taken to have occurred.

As noted earlier in this attachment, the NER list a number of relevant factors to which we must have regard in making a determination on a pass through application, including any factors the AER considers relevant.<sup>28</sup> We consider including additional factors we consider relevant to a nominated pass through event in the event definition provides greater certainty and transparency in the operation of nominated pass through events. When assessing a pass through event, we will have regard to whether Jemena has taken prudent and efficient steps to insure against the event. We consider there may be some overlap between an insurance cap event and a natural disaster event, but accept the need to have both because the NSP may incur costs which an insurance policy would not ordinarily cover.

Whether a relevant government authority has made a declaration in respect of a natural disaster event is also a factor we would consider when assessing whether to approve such a pass through event. We have amended the event definition to

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<sup>25</sup> Jemena Electricity Networks (Vic) Ltd, *Regulatory Proposal 1 January 2016 - 31 December 2020*, April 2015, Attachment 5-4, p. 8.

<sup>26</sup> NER, glossary, definition of 'nominated pass through event considerations', paragraph (c).

<sup>27</sup> NER, glossary, definition of 'nominated pass through event considerations', paragraph (d).

<sup>28</sup> NER, cl. 6.6.1(j)(8).



incorporate these assessment factors. We consider this clarity supports the NER nominated pass through event considerations.<sup>29</sup>

Our amended definition is:

A natural disaster event occurs if:

Any major fire, flood, earthquake or other natural disaster occurs during the 2016–20 regulatory control period and materially increases the costs to Jemena in providing standard control services, provided the fire, flood or other event was not a consequence of the acts or omissions of the service provider.

The term 'major' in the above paragraph means an event that is serious and significant. It does not mean material as that term is defined in the Rules (that is 1 per cent of the DNSP's annual revenue requirement for that regulatory year).

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

- i. whether Jemena has insurance against the event,
- ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event,
- iii. whether a relevant government authority has made a declaration that a natural disaster has occurred.

### 15.4.5 Terrorism event

This event would allow Jemena to pass through the costs of terrorism events. We note Jemena's ability to forecast either the occurrence or cost impact of a terrorism event is limited. A prudent and efficient NSP may, however, be able to take actions which reduce the vulnerability of the network to terrorist attacks and would obtain insurance in respect of terrorism events. We note the measures Jemena currently has in place.<sup>30</sup>

We accept a terrorism event can be consistent with the nominated pass through considerations, if appropriately defined. We do not accept the proposed definition. We propose a new definition which supports the nominated pass through event considerations by incorporating factors we will have regard to when assessing a pass through application. These are the same factors as those discussed above in the context of the natural disaster event.

Whether a relevant government authority has made a declaration in respect of a terrorism event is a factor we will consider when assessing whether to a pass through event has occurred. This is therefore reflected in our definition. We will also consider what insurance Jemena has, what insurance an efficient and prudent distributor would

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<sup>29</sup> NER, cl. 6.5.10(b); NER glossary, definition of 'nominated pass through event considerations', paragraph (b), (d).

<sup>30</sup> Jemena Electricity Networks (Vic) Ltd, *Regulatory Proposal 1 January 2016 - 31 December 2020*, April 2015, Attachment 5-4, p. 12.

have, against the impact of a terrorism event. This is also reflected in our definition. We consider there may otherwise be some overlap between an insurance cap event and a terrorism event, but accept the need to have both because Jemena may incur costs which an insurance policy would not ordinarily cover.

For the reasons above, we do not accept Jemena's proposed definition of this event. Our preliminary decision is to instead approve a narrower and more clearly defined terrorism event, as follows:

A terrorism event occurs if:

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 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 which materially increases the costs to Jemena in providing standard control services.

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

- i. whether Jemena has insurance against the event,
- ii. the level of insurance that an efficient and prudent NSP would obtain in respect of the event, and
- iii. whether a declaration has been made by a relevant government authority that a terrorism event has occurred.

#### **15.4.6 Retailer insolvency event**

A retailer insolvency event would allow Jemena to pass through the costs for the provision of direct control services in the event of a retailer insolvency. Since the National Energy Customer Framework (NECF) has not been adopted in Victoria, the prescribed retailer insolvency event under the NER does not apply to Victorian distributors. We consider it appropriate to provide equivalent protection through a nominated pass through event.

Jemena has proposed its own definition of this event and in doing so has drawn on a rule change proposal currently under consideration by the AEMC. The outcomes of that process are, as yet, unknown. The assumptions made in Jemena's proposal therefore create the risk that a nominated pass through event approved in the terms it has proposed would be inconsistent with that applied in other jurisdictions.

To ensure that the protection afforded Victorian distributors remains consistent with that available to distributors in NECF jurisdictions, we therefore consider it best to apply the NER event 'as in force from time to time'. In this way, changes to the NER prescribed retailer insolvency event during the regulatory control period will also apply to Victorian distributors as they take effect.

We therefore approve the following, nominated pass through event for Jemena:

Prior to the commencement of the National Energy Customer Framework in Victoria, **retailer insolvency event** has the meaning set out in the NER as in force from time to time.

Note: This retailer insolvency event will cease to apply as a nominated pass through event on commencement of the National Energy Customer Framework in Victoria.

### 15.4.7 End of metering derogation event

An end of metering derogation event would allow Jemena to pass through costs associated with the end of the Victorian derogation from the metering provisions (under chapter 7 of the NER) and the introduction of metering contestability.

We do not accept the end of metering derogation event, as we consider it likely such an event will be covered under the regulatory change event or a service standard event, depending on the final form the framework takes.<sup>31</sup>

Jemena argues it may incur at least some of the costs prior to the expiration of the derogation. Jemena has not provided further information about what these costs may be.

Metering contestability promotes competition in the marketplace and may be beneficial for consumers. We are of the view that Jemena is in a better position than its customers to bear the risk of this type of event. It is not appropriate for NSPs to recover from their monopoly customers the cost of upgrading IT systems required to compete with third party metering providers. If a NSP incurs costs prior to the expiration of the derogation, in preparation for metering contestability, the NSP should bear the costs. NSPs were aware in advance that the derogation was ending, as part of normal business operation they should be prepared to respond to changes in the marketplace.

### 15.4.8 Carbon cost event

A carbon cost event would allow Jemena to recover costs imposed by any Carbon pricing scheme. We note Jemena's arguments that:

- all DNSPs face significant uncertainty regarding carbon policy over the next regulatory control period, citing that two federal elections fall within the 2016-20 period
- risk mitigation measure may not be feasible due to the nature of the risk.<sup>32</sup>

We do not accept a carbon cost event because it is covered by one of the prescribed pass through events. If a regulatory policy or requirement imposes additional costs on

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<sup>31</sup> NER, glossary, definition of 'nominated pass through event considerations', paragraph (a).

<sup>32</sup> Jemena Electricity Networks (Vic) Ltd, *Regulatory Proposal 1 January 2016 - 31 December 2020*, April 2015, Attachment 5-4, p. 12.

Jemena, then it is likely Jemena could submit a pass through application under the prescribed regulatory change or tax change events. Jemena did not provide any explanation why the carbon cost event would not already be covered by the regulatory change event or tax change event.

Accordingly, we do not consider there is a need for a nominated pass through event to cover the potential costs of this event, beyond those set out in the NER or approved in this determination.<sup>33</sup>

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<sup>33</sup> NER, glossary, definition of 'nominated pass through event considerations', paragraph (a).