# Jemena Electricity Networks (Vic) Ltd

## 2016-20 Electricity Distribution Price Review Regulatory Proposal

Attachment 5-4

Risk Management Framework

Public

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# ABBREVIATIONS

| | |
|---|---|
| AEMC | Australian Energy Markets Commission |
| AMI | Advance Metering Infrastructure |
| DNSP | Distribution Network Service Provider |
| JCARS | Jemena Compliance and Risk System |
| JEN | Jemena Electricity Networks |
| NECF | National Energy Customer Framework |
| NER | National Electricity Rules |

# 1. SUMMARY

1. It is important that our customers only pay what is necessary for us to provide the network services that customers' value. It's also important that we have the funding necessary to provide these services.

2. We are required to forecast our costs and the revenue required to recover our costs over the next 5 years. Like most businesses, we are unable to perfectly predict and manage all the challenges we and our customers may face over the next 5 years. For example, external impacts - such as natural disasters - or changes in Government policy, or changes in the way the energy market operates can be extremely challenging to manage and predict in advance despite our best efforts.

3. Managing these risks requires safeguards—a 'pass through mechanism'—which allows the AER to adjust our network prices up or down in response to unforseen, uncontrollable and material changes that impact us and our customers. This ensures that our forecast operating and capital costs do not include any speculative and significantly large allowances for events that may not occur. It is in customers' interest to only pay what is necessary for us to provide the network services they value.

4. We have carefully considered our unique operating environment and our ability to manage these events in a cost effective way. In addition to the pass through events specified in the National Electricity Rules (**NER**), we have identified and proposed six pass through events for the 2016-20 period for our direct control services. These are summarised in Table 1–1.

5. Jemena Electricity Networks (Vic) Ltd (**JEN**) proposes that pass through events apply to both standard control services and alternative control services.

**Table 1–1: JEN's proposed nominated pass through events**

| Pass through event | Proposed definition |
|---|---|
| Natural disaster event | 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. |
| Insurer credit risk event | The insolvency of the DNSP's insurer, as a result of which the DNSP:<br>(a) incurs higher or lower costs for insurance premiums than those allowed for in the distribution determination;<br>(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<br>(c) incurs additional costs associated with self-funding an insurance claim, which, would have otherwise been covered by the insolvent insurer. |
| Insurance cap event | An event where:<br>(a) the DNSP makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy;<br>(b) the DNSP incurs costs beyond the relevant policy limit; and<br>(c) the costs beyond the relevant policy limit increase the costs to the DNSP of providing direct control services.<br>For this Insurance Cap Event:<br>(a) the relevant policy limit is the greater of:<br>(a) the DNSP's actual policy limit at the time of the event that gives, or would have given rise to the claim; and<br>(b) the policy limit that is explicitly or implicitly commensurate with the allowance for insurance |

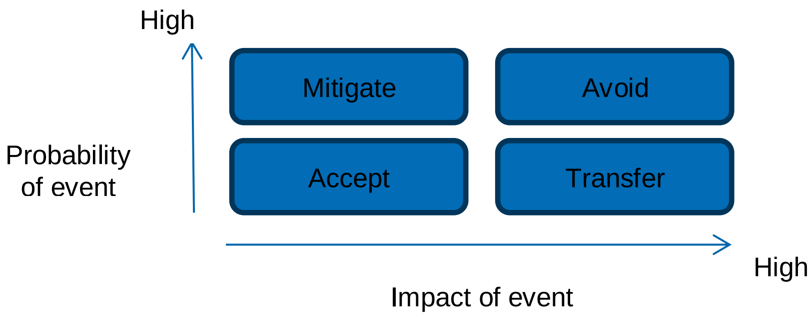
| Pass through event | Proposed definition |
|---|---|
| | premiums that is included in the forecast operating expenditure allowance approved in the AER's final decision for the regulatory control period in which the relevant insurance policy is issued;<br>(b) a relevant insurance policy is an insurance policy held during the regulatory control period or a previous regulatory control period; and<br>(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. |
| Terrorism event | 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 increases the costs to the DNSP in providing direct control services, to the extent those costs are not recovered from a third party. |
| Carbon cost event | 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.<br>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. |
| Retailer insolvency event | 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:<br>(a) an insolvency official has been appointed in respect of that retailer; and<br>(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,<br>and as a result of which the DNSP incurs, or will incur costs.<br>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. |
| End of metering derogation event | 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:<br>(a) system costs for establishing metering contestability;<br>(b) meter provider of last resort costs; and<br>(c) costs incurred to obtain non-metrology data from meters to enable the distributor to operate its network.<br>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. |

# 2. OUR RISK MANAGEMENT FRAMEWORK

## 2.1 OPTIONS FOR MANAGING RISK

6. Most businesses, including JEN, will seek to manage risk in one of four ways, as set out in Figure 2–1.

**Figure 2–1: Risk management options matrix**




7. JEN will, generally:

- **Mitigate** risks where they consider it a relatively high chance of occurring, but have a relatively low impact on costs—for example, JEN mitigates impact of storm events through our vegetation management programs and emergency response management plans
- **Avoid** risks that are very likely to occur and would be particularly damaging to the business—JEN avoids any activity that they consider an unacceptable health and safety risk to their employees, customers and the community.
- **Transfer** risks that are of relatively unlikely to occur and would be particularly damaging to the business if they did eventuate—for example, JEN may take out third party insurance to transfer a risk that we are unable to fully mitigate or avoid.
- **Accept** risks that are reasonably low probability and low impact.

8. Cost pass through events reflect a mechanism by which Distribution Network Service Providers (**DNSP**), including JEN, transfer risks to their customers. We will look to avoid this risk management approach where other options are available. Like our insurers, our customers expect us to minimise—to the extent possible—the likelihood and impact of any risks transferred to them.

9. How we manage a particular risk depends upon the options available for managing that risk, and the efficiency of each option. Our risk management decision-making process is founded in our corporate risk management framework and associated risk management policies. We look to the framework and policy to guide us in choosing the optimal method of managing all risks in an efficient and effective manner.

## 2.2 OUR APPROACH TO RISK MANAGEMENT

### 2.2.1 RISK MANAGEMENT FRAMEWORK

10. JEN's risk management framework comprises an integrated package of corporate and asset-specific risk management policies, plans, and procedures. Additionally, JEN is committed to ensuring that risk management is embedded in the business operations and culture by encouraging the adoption of the following risk management approach:

- Everyone is a risk manager
- Risks are owned by the JEN business
- Risk management is embedded in normal business processes
- Risk management provides early warning enabling mitigation
- Risks are considered through both a top-down and bottom-up approach

11. The risk management approach at JEN is underpinned by key principles consistent with AS/NZS ISO 31000:2009 and section 4.4.7 (Risk Management) of PAS 55-2:2008 Asset Management: risk management policy. These principles are that risk management:

- Creates and protects value
- Is an integral part of all JEN business processes
- Is part of decision making
- Explicitly addresses uncertainty
- Is systematic, structured and timely
- Is based on the best available information
- Is tailored
- Takes human and cultural factors into account
- Is transparent and inclusive
- Is dynamic, iterative and responsive to change
- Facilitates continual improvement of the JEN business

### 2.2.2 RISK MANAGEMENT POLICY

12. Jemena's risk management policy strives to ensure that we take a systematic and strategic approach to identifying and managing risk and meeting business objectives.

13. The policy and the risk management approaches adopted are also consistent with best practice principles and the Australian risk management standard, AS/NZS ISO 31000:2009. The policy is designed to protect:

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

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

15. Our policy is supported by the Jemena risk management manual, which is a dynamic document designed to ensure that the Policy is implemented and risk management is embedded in our practices and processes. Together, this Policy and the Risk Management Manual formalise and set out our risk management framework. Our risk management framework and policy are also supported by specific Jemena policies and standards, such as:

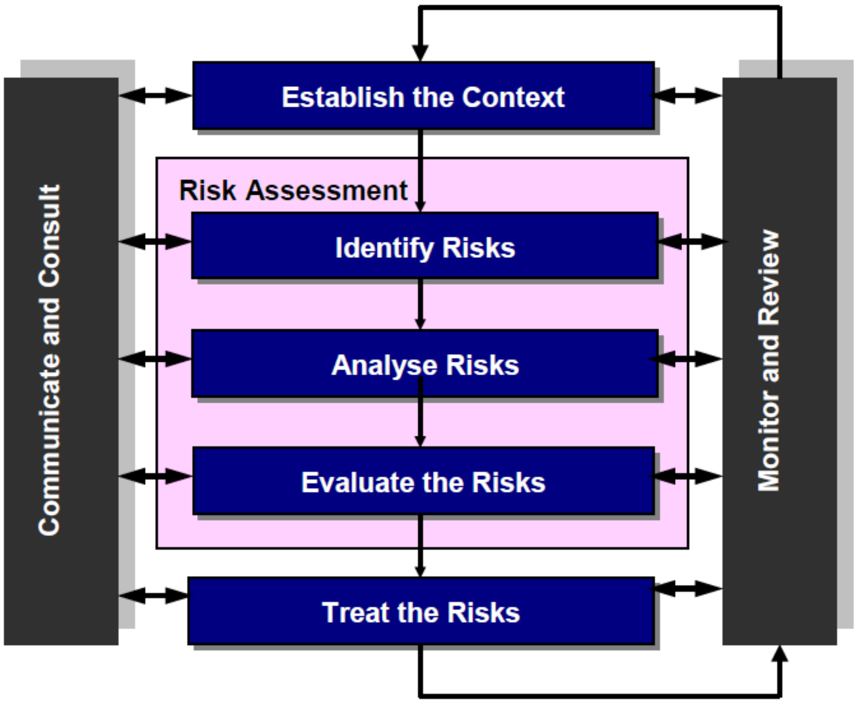
- Code of conduct
- Compliance with the law policy
- Health and safety policy
- Environment policy
- Whistle-blower policy
- Corrective action policy
- Fraud control policy
- Asset management policy.

16. Jemena's risk appetite is reflected in the risk consequence materiality table which is contained in the Risk Management Manual. The parameters for risk consequence materiality vary by the nature of risks and are defined based on a five-point scale, ranging from minor to catastrophic. Magnitude of consequence is determined with respect to Jemena's risk capacity, risk appetite and organisational objectives.

### 2.2.3 RISK MANAGEMENT PROCESS

18. Risk management is ultimately achieved through JEN's risk management process, set out in Figure 2–2:

**Figure 2–2: JEN's risk management process**




19. Risk management at JEN is an iterative process, whereby nominated JEN risk facilitators will ensure the key risk management activities are implemented, reviewed and re-assessed at a reasonable and appropriate frequency. The risk management process involves:

- Establishing the risk context
- Assessing the risk through defining the risk and identifying its cause(s)
- Analysing the risk through consequence analysis, likelihood analysis, untreated risk assessment, control assessment, identifying potential controls and mitigation actions, assessing control effectiveness and assessing residual risks
- Evaluating the risk including risk prioritisation, escalation and reporting requirements
- Treating the risk through a risk treatment options.

20. Communication is a two way dialogue between the stakeholders identified in the early part of the risk management process and Management. Where risks are identified that are unacceptable, it is the identifier's responsibility to communicate such risks to the appropriate level of Management based on the risk evaluation.

21. Both monitoring and review are planned part of the risk management process and involve regular checking or surveillance. It can be periodic or ad hoc.

22. JEN uses the Jemena compliance and risk system (**JCARS**) as a risk register for high and extreme risks, and all other risks are maintained by the respective JEN business units.

# 3. COST PASS THROUGH EVENTS

23. JEN's proposed cost pass through event list reflects risks which are not captured in:

- The allowed rate of return—the risk coefficients in JEN's proposed rate of return assumes a normal (i.e symmetric) distribution of returns, whereas cost pass through events capture risks which are asymmetric in nature
- The capex or opex forecasts, including through insurance, self-insurance, or emergency response forecasts
- Any other relevant mechanism or allowance.

24. The events are outside the control of JEN and therefore our approach reflects an efficient allocation of risk.

25. The Rules provide for and define a number of events for which a pass through of costs is added to a DNSP's allowable revenue during a regulatory control period, on an ex-post basis (rather than being included in the allowance at the time of the determination) if they have a material impact on the DNSP.

26. The AER is of course not required to approve a cost pass through just because a nominated event has occurred. JEN must apply to the AER to seek pass through of prudent and efficient costs arising from the event. Thus, pass through events do not remove regulatory oversight. Therefore, in relation to each nominated pass through event, JEN has an incentive to operate efficiently and mitigate its increased costs.

27. Clause 6.6.1(a1) of the Rules sets out specific pass through events for a DNSP, namely:

- A regulatory change event
- A service standard event
- A tax change event
- A retailer insolvency event
- Any other event specified in a distribution determination as a pass through event for the determination.

28. Under clause 6.13(a)(14), the AER must make a decision on the additional pass through events that JEN are to apply for the regulatory control period.

29. When determining whether to accept another event specified by a DNSP in its regulatory proposal as a nominated pass through event, the AER is required to take into account the following considerations:

- Whether the nominated event is captured by the pass through events already prescribed in the Rules
- Whether the nature or type of the nominated event can be clearly identified at the time of the determination
- Whether a prudent DNSP could reasonably prevent an event of that nature or type from occurring or substantially mitigate the cost impact of such an event
- Whether the DNSP could externally insure against the event, having regard to the availability of insurance against that event on reasonable commercial terms
- Whether the DNSP could self-insure against the event on the basis that a premium can be determined and the potential cost would not have a significant impact on the DNSP's ability to provide network services

- Any other matter the AER considers relevant and which the AER has notified DNSPs is a nominated pass through event consideration.[1]

## 3.1 PROPOSED NOMINATED PASS THROUGH EVENTS

30. JEN considers that the following events qualify as nominated pass through events:

- A natural disaster event
- An insurer credit risk event
- An insurance cap event
- A terrorism event
- A carbon cost event
- A retailer insolvency event
- An end of metering derogation event.

### 3.1.1 NATURAL DISASTER EVENT

31. JEN's proposed operating expenditure allowance for emergency response provides cover only to the level of emergency response expenditure incurred in the base year. JEN is of the view that the risk of a natural disaster event imposing losses greater than the materiality threshold defined in the Rules cannot be mitigated by JEN as external insurance is prohibitive and a self-insurance premium cannot be determined.

32. Therefore JEN proposes to include a natural disaster event as a nominated pass through event for the 2016-20 regulatory control period. JEN proposes the following definition:

> *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.*

33. JEN considers that a natural disaster event qualifies as a nominated event because it meets the AER's criteria and the nominated pass through event considerations set out in the Rules.

34. JEN applies mitigation measures to try and limit the cost impact of natural disasters through its organisational resilience framework and associated plans. Key policies and frameworks are set out in Table 3–1. Each is available on request.

**Table 3–1: Organisational resilience and emergency management policies and frameworks**

| Policy / Framework | Purpose and scope |
|---|---|
| Organisational resilience policy | Ensures that there is a systematic, integrated and strategic approach to strengthening our preparedness, timely response, and rapid recovery in the event of a business disruption event. |

1 JEN has not been notified of any further consideration.

| Policy / Framework | Purpose and scope |
|---|---|
| Organisational resilience framework | Supports the prioritisation of resiliency initiatives and investments to ensure that resources are applied where they offer the most benefit for mitigating risk by lessening vulnerabilities, deterring threats, and minimising the consequences of disruptive events. |
| Crisis management plan | Jemena's Crisis Management Plan describes the Crisis Management Team structure, activation and escalation processes as well as roles and responsibilities during any incident or issue that could have the potential to seriously threaten Jemena's reputation, its operations and/or the safety and well-being of its employees as well as others who may be affected by our actions. |
| Emergency management framework | This framework allows Jemena business units nominated for emergency roles to manage an emergency through clear and defined objectives when responding pre, during and post an emergency. |
| Electricity emergency management and response plan | Describes the Emergency Management arrangements concerning electricity asset-based emergency risks. The plan defines roles and responsibilities for the Emergency and Area Management Teams. The Plan represents Jemena's commitment to its stakeholders, its network and the community to respond to critical emergencies promptly and efficiently |
| Bushfire mitigation plan 2014-2019 | Prepared for the purposes of the Electrical Safety Act (1998) and the Electricity Safety (Bushfire Mitigation) Regulations 2013 and to inform stakeholders of the asset management approach, processes and strategies adopted for bushfire mitigation. |
| Electric line clearance management plan | The objective of this Plan is to clearly define the management processes and procedures that we adopt to ensure compliance with the requirements of the Electricity Safety (Electric Line Clearance) Regulations 2010, including management procedures to minimise danger of trees contacting electric lines resulting in fire or electrocution. |

### 3.1.2 INSURER CREDIT RISK EVENT

35. JEN proposes to include an insurer credit risk event as a nominated event for the 2016-20 regulatory control period. The proposed definition is:

> *Insurer credit risk event means the insolvency of the DNSP's insurer, as a result of which the DNSP:*
>
> *(a) incurs higher or lower costs for insurance premiums than those allowed for in the distribution determination; or*
>
> *(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.*
>
> *(c) incurs additional costs associated with self-funding an insurance claim, which, would have otherwise been covered by the insolvent insurer.*

36. JEN's insurance broker monitors the credit ratings and financial capabilities of the insurance carriers on its approved list. This is a requirement in the services agreement we have with our insurance broker, and they must also provide us market intelligence and updates on a regular basis including credit reports, as reasonably requested, on underwriters to assist in the monitoring of our insurers' credit standing. An example report is available on request.

37. Each insurer is analysed regularly. The review undertaken by Aon is based on an extensive assessment of the insurers' credit ratings and takes into consideration a wide range of quantitative and qualitative information. Our corporate group's insurance policies are placed with insurers with a credit rating of a minimum of A- by Standard & Poor's or the equivalent credit rating agencies.

38. JEN considers that an insurer credit risk event meets the AER's criteria and the nominated pass through event considerations set out in the Rules.

39. JEN notes that the AER approved this as a nominated pass through event for JEN in its determination for the 2011-15 period. However, the AER draft decision for the Networks NSW businesses proposes to reject this event for two reasons[2]:

> *…because a prudent service provider could reasonably prevent an event of that nature from occurring*

and

> *…we may encourage NSPs to obtain insurance from providers who are not capable of paying large claims or to not monitor or review the viability of their insurance provider.*

40. Both these reasons are not based on sound rationale.

41. On the first reason, a prudent service provider cannot always prevent or anticipate the failure of an insurance provider. The AER needs only to consider the cause and impact of the HIH Insurance collapse in 2001 and the AIG Insurance difficulties during the Global Financial Crises in 2009. Both these companies were widely considered to be strong and reputable insurance companies prior to the difficulties they experienced.

42. On the second reason, it is simply unacceptable and would be non-compliant with corporate policy and governance requirements for JEN to take out insurance with insurers it knew to be unviable. The SGSPAA Group takes a number of precautions to mitigate JEN's exposure to an insurer's credit risk event including (as noted above):

- The appointment of a global insurance broker with the ability and the resources to place the SGSPAA Group insurance program and to also monitor the credit risk of all insurers.
- The inclusion of conditions in our contract with our broker that all insurers we deal with must be rated Standard & Poors (or equivalent agency) A- or better.
- The receipt of quarterly insurer security rating reports from our broker in relation to credit rating and reputation.
- The diversification of the insurance portfolio, particularly the larger insurance policies (general liability and industrial special risks (property insurance))

2 AER, *Ausgrid draft decision 2015-16 to 2018-19*, November 2014, pp15-13 to 15-14

43. It would also be completely irrational for us to act imprudently in this regard because we know that the AER must (and will) consider the prudency of our actions when assessing any pass through claim. As set out in the NER (cl 6.6.1), the AER must take into account:

> *in the case of a positive change event, the efficiency of the Distribution Network Service Provider's decisions and actions in relation to the risk of the positive change event, including whether the Distribution Network Service Provider has failed to take any action that could reasonably be taken to reduce the magnitude of the eligible pass through amount in respect of that positive change event and whether the Distribution Network Service Provider has taken or omitted to take any action where such action or omission has increased the magnitude of the amount in respect of that positive change event.*

44. We believe there are strong checks and balances in place—both internally as a matter of proper corporate governance, and through the regulatory regime—to remove any incentives for us to act inappropriately in reliance on the insurer's credit risk pass through event.

### 3.1.3 INSURANCE CAP EVENT

45. JEN proposes to include an insurance cap event as a specific nominated pass through event for the 2016-20 regulatory control period. Due to the nature of the risk, JEN is unable to develop risk mitigation measures. The proposed event definition is:

*An event where:*

*a) the DNSP makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy;*

*b) the DNSP incurs costs beyond the relevant policy limit; and*

*c) the costs beyond the relevant policy limit increase the costs to the DNSP of providing direct control services.*

*For this Insurance Cap Event:*

*a) the relevant policy limit is the greater of:*

*i) the DNSP's actual policy limit at the time of the event that gives, or would have given rise to the claim; and*

*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;*

*b) a relevant insurance policy is an insurance policy held during the regulatory control period or a previous regulatory control period; and*

*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.*

46. The rationale for proposing an insurance cap event is because external insurance for this type of high impact/low probability risk event may not be available or is available on terms or conditions that are not reasonably commercial.

47. JEN submits that an insurance cap event that qualifies as a nominated event because it meets the AER's criteria and the nominated pass through event considerations set out in the Rules.

### 3.1.4 TERRORISM EVENT

48. JEN proposes to include a terrorism event as a specific nominated pass through event for the 2016-20 regulatory control period. JEN submits that this event qualifies as a nominated event because it meets the AER's criteria and the nominated pass through event considerations set out in the Rules. The proposed event definition is:

> *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 increases the costs to the DNSP in providing direct control services, to the extent those costs are not recovered from a third party.*

49. [c-i-c]

50. [c-i-c]

51. [c-i-c]

52. [c-i-c]

### 3.1.5 CARBON COST EVENT

53. JEN, like all DNSPs, faces significant uncertainty regarding carbon policy over the next regulatory control period. With two federal elections falling within the 2016-20 period and increasing international focus on Australia following landmark climate change initiatives agreed between the United State of America and China, carbon policy and the form and nature of costs imposed as a result of that policy over the next five years are very much unclear. Further, due to the nature of the risk, JEN is unable to develop risk mitigation measures.

54. JEN therefore proposes to include a carbon cost event as a pass through event for the 2016-20 regulatory control period. The proposed event is to be defined as follows:

> *A carbon cost event means 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.*

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[3] [c-i-c]

> *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.*
>
> *The event is drafted broadly to reflect the significant degree of uncertainty surrounding carbon policy over the next regulatory control period.*

### 3.1.6 RETAILER INSOLVENCY EVENT

55. As the National Energy Customer Framework (**NECF**) has not been adopted in Victoria, the retailer insolvency event in clause 6.6.1(a1)(4) of the NER does not currently apply to the Victorian DNSPs. JEN therefore proposes to nominate a retailer insolvency event pursuant to clause 6.6.1(a1)(5) that is defined in the following way:

> *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:*
>
> *(a) an insolvency official has been appointed in respect of that retailer; and*
>
> *(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.*
>
> *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.*

56. The above definition reflects the definition of the event in chapter 10 of the NER and also incorporates a rule change to the NER that has been proposed by the COAG Energy Council[4] and is intended to clarify that electricity distributors can recover revenues foregone from retailer insolvency. This amendment should have been made to the NER along with other amendments to implement the NECF. The proposed definition differs, however, from the proposed rule change drafting given that the nominated pass through event must work within the positive and negative pass through process in clause 6.6.1 of the NER.

57. In JEN's view, the nominated retailer insolvency event meets the nominated pass through event considerations set out the NER. In particular, JEN notes that:

- The event proposed is not already in the NER as the NECF amendments to the NER have not been adopted by Victoria
- The event is clearly identified and JEN has used the definition of retailer insolvency event in the NER (with the proposed rule change amendments) to ensure achieve this
- A prudent service provider could not reasonably prevent a retailer insolvency event from occurring or substantially mitigate the cost impact of such an event as it cannot refuse to do business with a retailer even if considered not creditworthy
- JEN cannot insure against the event on reasonable economic terms
- JEN cannot self-insure the event on the basis that it is not possible to calculate the self-insurance premium because the probability of the event occurring cannot be readily estimated and the potential cost would have a significant impact on JEN's ability to provide network services

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[4] COAG, *Definition of retailer insolvency costs – rule change request*, March 2014 (available on the AEMC's website).

- As the event is already included in the NER and is effective in jurisdictions other than Victoria, inclusion of the event in the JEN distribution determination would achieve consistency across jurisdictions.

58. If NECF is adopted in Victoria during the 2016-20 regulatory control period, JEN's proposal is that this nominated pass through event will cease to apply as the defined retailer insolvency event will be a pass through event for JEN's distribution determination.

### 3.1.7 END OF METERING DEROGATION EVENT

59. JEN is proposing an event to pass through the costs associated with the end of the Victorian derogation from the metering provisions of chapter 7 of the NER and the introduction of metering contestability.

60. The derogation was intended to allow for the rollout of advance metering infrastructure (**AMI**) in Victoria by distribution businesses to small electricity customers. The derogation is found in clause 9.9C of the Rules, which was inserted into the Rules following a rule change made by the Australian Energy Markets Commission (**AEMC**) in November 2013 (National Electricity Amendment (Victorian Jurisdictional Derogation – Advance Metering Infrastructure). Clause 9.9(c) extended an existing derogation to the earlier of:

- the commencement in Victoria of a national framework for competition in metering and related services for residential and small business customers under the Rules
- 31 December 2016.

61. A rule change to introduce a framework to promote competition in metering and related services is currently before the AEMC. The AEMC made its draft determination on the rule change in March 2015 and key aspects of the draft rule (which will amend chapter 7 of the Rules) as follows:

- The role and responsibilities of the existing "Responsible Person" is to be provided by a new type of registered participant – a Metering Coordinator – who will have primary responsibility for provision of metering services, including ensure security of, and access to, advanced meters
- Any person can be a Metering Coordinator, subject to meeting registration requirements, and a large customer can appoint its own Meter Coordinator
- Customers can deal solely with their retailer and draft rule sets out the circumstances in which a small customer may opt to not have a new meter installed at their premises
- The minimum services that a new or replacement meter installed at a small customer's premises must be capable of providing are specified
- A retailer will be able to arrange for a Metering Coordinator to remotely disconnect or reconnect a small customer's premises in certain circumstances
- Changes to the model terms and conditions of standard retail contracts to reflect changes in the parties providing metering services.

62. The draft rule states that these changes will start on 1 July 2017, but certain provisions may start earlier to enable parties to take implementation steps before 1 July 2017.

63. For Victoria, the AEMC's draft rule includes the following transitional arrangements in light of the derogation and AMI program:[5]

[5] AEMC, *Draft Rule Determination, National Electricity Amendment (Expanding competition in metering and related services) Rule 2015*, 26 March 2015, p 277.

- At the commencement of the new Chapter 7 of the NER, the Victorian DNSPs will become the initial Metering Coordinator for the advanced meters they deployed under the AMI program and will continue in this role until another Metering Coordinator is appointed to the site or the services cease to be classified as a direct control service;

- The derogation in rule 9.9C of the NER will be extended by six months so that it ends on the date the new Chapter 7 of the NER commences. This means that the Victorian DNSPs will no longer be able to provide metering services on an exclusive basis after that date, and other parties will be able to take on the Metering Coordinator role;

- If a new Metering Coordinator is appointed to replace the DNSP, an exit fee may be payable. Until 31 December 2020, the exit fee payable will be determined by the AER in accordance with the AMI Cost Recovery Order. After 2020, the AER will determine the level of any exit fee under the same arrangements as in other jurisdictions if the metering services continue to be classified as a direct control service;

- Victorian DNSPs will be able to continue to use the meters they deployed under the AMI program as network devices, if they choose to do so as a result of being unable to reach an agreement with a new Metering Coordinator.

- The national minimum services specification will take effect in Victoria when the new Chapter 7 of the NER commences.

64. It is anticipated that the final rule change will be made in July 2015, with the following implementation steps to take place in the lead up to 1 July 2017:

- AEMO to develop, consult on and publish new and updated procedures by 1 April 2016;

- the AER to publish ring-fencing guidelines by 1 July 2016;

- AEMO to publish information on registering as a Metering Coordinator by 1 October 2016; and

- retailers to publish amended standard retailer contracts by 1 July 2017.

65. In this context, JEN anticipates that it will have to implement new, or change existing, systems and processes to be ready for the end of the Victorian derogation and the new metering contestability framework.

66. As the AEMC has only released a draft determination and certain procedures and guidelines are yet to be published, there is uncertainty as to JEN's role and responsibilities in respect of metering services, the scope of the systems changes it will have to implement (and the cost involved), and the need for additional operating and capital expenditure to ensure it is fully compliant.

67. JEN is therefore proposing the following "end of metering derogation event" as a nominated pass through event:

> *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:*
>
> *(a) system costs for establishing metering contestability;*
>
> *(b) meter provider of last resort costs; and*
>
> *(c) costs incurred to obtain non-metrology data from meters to enable the DNSP to operate its network.*
>
> *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.*

68. In JEN's view, this event meets the nominated pass through event considerations:

- It is not covered by another category of pass through event. Although there is a change in regulatory change or obligation, the costs referable to the introduction of metering contestability and the end of the Victorian derogation are likely to be incurred prior to that change and in preparing for full compliance with the metering contestability framework when it commences for the Victorian businesses. The event therefore does not fall within the regulatory change event
- The nature or type of event can be clearly identified. As outlined above, there is a clear timetable for the various metering contestability changes such that the event can be clearly identified and is likely to occur in the 2016-20 regulatory control period. It is also evident that JEN will have to take steps in advance of the end of the Victorian derogation to facilitate metering contestability
- JEN could not reasonably prevent an ending of the metering derogation event from occurring or substantially mitigate the cost impact of such an event. The introduction of metering contestability and the end of the Victoria derogation will be decided by the AEMC. While some steps could be taken by JEN to mitigate the cost impact, including leveraging systems and processes JEN put in place to comply with the AMI program in Victoria, they are likely to be limited given the uncertainties associated with the metering contestability framework
- JEN cannot insure against this event given the uncertainties associated with the framework and the scope of JEN's role and responsibilities under the framework and the system changes necessary to facilitate metering contestability.