

29 October 2020

Mr Sebastian Roberts
General Manager
Transmission and Gas
Australian Energy Regulator (AER)
GPO Box 520
Melbourne VIC 3001

Dear Mr Roberts

CONSULTATION PAPER – GUIDANCE NOTE ON ASSESSING INSURANCE COVERAGE EVENT APPLICATIONS

Endeavour Energy appreciates the opportunity to provide this response to the AER's consultation paper and supports the AER clarifying the factors it will consider when reviewing insurance coverage pass-through event applications. A guidance note will better inform applicant networks of possible assessment outcomes and enable efficient insurance decisions to be made in the context of changing insurance markets.

Material changes in insurance markets have impacted the ability of networks to obtain coverage under the same terms of previous policies at a similar cost. This broadly stems from insurer concerns about the increasing frequency of major (often weather related) incidents and events both in Australia and internationally and the potential for claim amounts to significantly exceed the annual premium pool paid by electricity networks on a regular basis. Bushfire litigation risk in particular is driving diminishing insurance capacity and increasing premiums offered by insurers who - as we encountered during recent renewal negotiations for our general liability policy - are increasingly adopting a "take it or leave it" position to their bushfire exposed clientele.

The AER has not yet had to assess an insurance coverage pass-through event however, these market trends have increased the potential for such applications. This is particularly the case when the increased cost of insurance premiums approaches or exceeds the insured event's risk cost or coverage becomes unavailable on reasonable commercial terms (either wholly or in-part). Where insurance is not available on commercial terms it may become more efficient and cost-effective for networks to share more risk with customers via increased risk mitigation expenditure programs and/or via pass-throughs.

We note in recent decisions that the AER has amended the definition of an insurance coverage event to better recognise that gaps may appear in a network's insurance coverage if withdrawn capacity cannot be filled by suitable providers or higher premium costs cannot be economically justified. We welcome this change to better allow for changes (outside of the network's control) in insurance policies and consider the additional amendments proposed by Jemena which are intended to clarify the circumstances in which the event is triggered and should be adopted.¹

Whilst networks (including Endeavour Energy) have generally accepted higher premium costs to protect against losses from low probability high consequence events, sustained volatile and challenging market conditions will require networks to reassess how risk is most efficiently shared with customers. Where coverage is available but at higher cost, networks will need to carefully examine the maximum level to which premiums or excess costs could rise before eliminating risk through insurance is likely to be considered imprudent or inefficient.

¹ AER, Attachment 15: Pass through events, Draft decision – AusNet Services 2021–26, September 2020, p. 22-24 ([link](#))

In the event a network incurs costs beyond a relevant policy limit and an insurance coverage pass-through application is subsequently made, it is appropriate for the network provider to demonstrate the reasonableness of their insurance coverage and risk sharing decisions. The AER's decision should be guided by comparing these decisions against those of a hypothetical efficient and prudent network in respect to the event which is broadly consistent with the approach used to assess expenditure proposals. For this assessment to be meaningful and informative, comparisons should have regard to several factors and circumstances (both unique to the applicant and common to all networks) underpinning coverage limits particularly where they differ from historical levels in response to prevailing adverse market conditions.

Key elements of the assessment process

We welcome the development of a guidance note that clarifies how the AER would approach an assessment of an insurance cost pass-through and the list of materials that the AER would expect to receive in order to make an assessment.

Networks should be able to demonstrate that their insurance coverage represents an efficient risk allocation between current and future customers and networks. It is important to note that the network insurance market is highly complex and commercially sensitive. A networks insurance lines and coverage are bespoke packages that reflect each networks operating environment, jurisdictional and regulatory requirements, network design, construction and operation and each networks risk management approach.

Assessing a networks coverage will include two key elements; the quantification of risk and the allocation of risk between a network provider and its customers. We consider independent advice from an insurance expert will be a key component of assessing the first element.

An independent expert will be able to review the actuarial and predictive modelling techniques used to quantify risk exposure. This quantification also involves expert judgment and the application of actuarial industry standards. They will also be able to review due diligence and controls in a network's selection of coverage limits, organisational risk tolerance and insurance risk strategy. Whilst benchmarking is of limited value, as discussed below, an expert may be able to provide insight as to significant variations in insurance coverage over time and between networks.

Customer engagement can help inform the second element of the AER's assessment of the efficient allocation of risk. Whilst this engagement will be limited by the commercial sensitivity and complexity of insurance markets it could help inform the extent to which customers are willing to be exposed to the financial impacts of insurance coverage gaps.

Given the commercial sensitivity and complexity around insurance we would expect that customer engagement on insurance would be targeted at a higher level such as understanding community expectations around risk tolerance for catastrophic events and how networks manage these. Customer feedback may also be required to help inform the extent to which customers are willing to be exposed to the financial impacts of insurance coverage gaps.

Annual information requirements

The consultation paper seeks feedback on whether an annual information process should be established to update the AER on material changes in a network's insurance position or to enable benchmarking across other network providers.

As noted above, the insurance market is highly complex and involves commercially sensitive information. Further, each network's insurance coverage is a bespoke, negotiated package that is reflective of its network characteristics, risk appetite and operating environment. It may therefore be inappropriate to benchmark insurance coverage and costs.

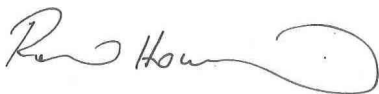
We consider the determination process provides an opportunity for the AER and stakeholders to scrutinise a network's insurance position in its base year used for forecasting purposes. It also allows networks to build in a forecast expectation of material changes via step changes to the extent they can be reliably forecast. Where there are subsequent and unexpected changes that occur during a regulatory control period a network provider may wish to update stakeholders on this. This would allow a network to provide the AER with ongoing information on its approach to insurance. Schedule 1 of the Annual RIN could provide a mechanism by which DNSPs can provide any updates on material changes that have occurred in their insurance premiums or coverage.

We would prefer this to be on a voluntary basis, as opposed to defining 'materiality' in a way that mandates annual reporting. Given an insurance cost pass-through event is currently a rare occurrence, some networks may consider it more time and cost effective to have their insurance practices assessed as part of a cost pass-through application rather than reporting on it annually (although we would consider proactive disclosure to be a more optimal approach).

Alternatively, given the commercially sensitive nature of insurance we would also be supportive of one-on-one meetings and/or briefing the AER on our annual placement process where a material variation occurs. This, and the staggered nature of determinations, would provide the AER with an ability to remain well-informed of developments in the global insurance market.

If you wish to discuss this submission further please contact [REDACTED]

Yours sincerely

A handwritten signature in black ink, appearing to read "Rod Howard". The signature is fluid and cursive, with a large loop at the end.

Rod Howard
Deputy Chief Executive Officer