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To whom it may concern,

I provide the following submission on the Australian Energy Regulator's (AER) draft decision regarding SP AusNet's 'insurance pass through event'.

The AER's draft decision allows a distribution network service provider (DNSP) to pass through additional costs to households, particularly costs in excess of insurance associated with bushfire related insurance claims. The decision clears the way for DNSPs to apply for additional costs to be passed through to Victorian households.

This may result in victims of the Black Saturday bushfires contributing to class action settlements against DNSPs for their alleged role in causing some of the Black Saturday bushfires through higher electricity prices.

As the Victorian Shadow Minister for Energy, I believe this is an unacceptable decision. In addition to my moral opposition, there are strong policy arguments against the draft decision.

Perverse incentives

All regulatory frameworks create incentives for participants. Effective regulators create strong incentives that encourage participants to effectively manage risk. The draft decision does not meet this standard.

The draft decision creates a perverse incentive for DNSPs to underinvest in their distribution networks and/or take more risks given they are likely to be able to pass through any costs in excess of their insurance coverage.

This is a classic moral hazard issue where there is asymmetric information between parties. The DNSP has more information about how it is managing its network than the regulator. Given this, moral hazard may occur because DNSPs are insulated from risk as well as having more information about its actions and intentions than the regulator.

Poorly allocated risks

In principle, risks should be allocated to parties that can best manage them. Instead of delivering on this principle, the draft decision effectively transfers the risk of an 'insurance pass through event' to Victorian households given they are likely to pay for the costs through higher electricity bills. Households cannot manage the risk of an 'insurance pass through event' and nor is it a reasonable expectation that they should manage such a risk.



DNSPs are best-placed to manage the risk of an 'insurance pass through event' through effective management and oversight of their distribution networks.

Discouraging efficient DNSPs

The purchase of insurance to mitigate risk is part of normal commercial operations. DNSPs should be responsible for managing their risk by purchasing appropriate insurance coverage. This argument is strengthened by the information asymmetry that exists between DNSPs and the regulator.

If insurance coverage is insufficient to cover a DNSP's exposure, the additional costs should be borne by the corporation through its shareholders.

The draft decision creates a situation where households pay for the services DNSPs provide through their electricity bills but are also the insurer of last resort. This is inappropriate and discourages risks being borne by DNSPs.

Retrospective and discretionary decision-making

As a matter of principle, it is agreed that regulatory decisions should not be retrospective. Given this, it is disappointing that the draft decision includes insurance policies that were entered into in previous regulatory periods.

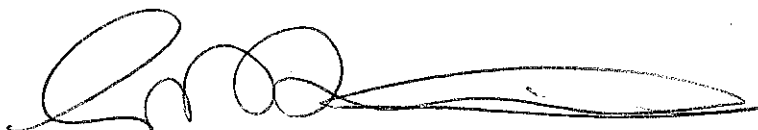
The draft decision to include a nominated pass through event is especially disappointing considering it is a discretionary matter for the AER. The National Electricity Rules do not specify any considerations for the AER to take into account in its deliberations.

Weak transparency

On 5 April 2012, the Australian Competition Tribunal ordered that the 'insurance pass through event' decision be sent to the AER for re-making. The reasons for this decision have not been disclosed and remain confidential. Given the costs of this decision may ultimately be borne by Victorian households this decision is troubling. It also means the entire process lacks transparency.

Thank you for the opportunity to provide a submission on the AER's draft decision regarding SP AusNet's 'insurance pass through event'.

Yours sincerely



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