

Determination

ElectraNet's 2021-22 Insurance Cost Pass Through

March 2022

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AER reference: 212938

Amendment record

Version	Date	Pages

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Overview

On 16 December 2021, ElectraNet submitted a cost pass-through application for an insurance event, seeking to recover incremental revenue of \$3.4 million in relation to an increase in its insurance premiums for the 2021-22 regulatory year. The Australian Energy Regulator (AER) must make a determination on ElectraNet's cost pass through application and, if an insurance event occurred, determine the approved pass-through amount.

We published ElectraNet's cost pass through application on 14 January 2022 and sought submissions from interested stakeholders. No submissions were received.

For a positive pass through to be determined in a cost pass through application, there must be a positive change event, that is:

- a pass through event specified in either the National Electricity Rules (NER) or in the current revenue determination for ElectraNet
- that event must entail ElectraNet incurring materially higher costs in providing prescribed services than it would have incurred but for the event.

ElectraNet may then submit a pass through application,¹ which must address certain matters specified in the NER.²

We must then make a determination on ElectraNet's cost pass through application and, if a positive change event occurred, determine the approved pass through amount and the regulatory year(s) in which the pass through amount is to be recovered. In making our determination on ElectraNet's pass through application, we must have regard to certain matters specified in the NER.³

We are satisfied that the material increase in ElectraNet's insurance premium costs in 2021-22 above its insurance premium forecast⁴ for that year meets the definition of an insurance event. We are also satisfied that the materiality threshold to constitute a positive change event has been met. Further, ElectraNet's cost pass through application also demonstrated that it has undertaken measures to ensure its insurance premium costs, and therefore the proposed pass through amount, are efficient.

Our determination is to approve a positive pass through amount of \$3.4 million (\$nominal) to be recovered in 2022–23.

We estimate that the approved cost pass through amount will add approximately \$1.96 (\$nominal) to residential consumer bills in the 2022-23 year.

¹ NER, cl 6A.7.3(a)

² NER, cl 6A.7.3(c)

³ NER, cl 6A.7.3(j)

⁴ The insurance premium forecast is referred to in Chapter 10 (definition of 'insurance event') of the NER as the allowance for the deductible (if any) that is provided for in the maximum allowed revenue for the provider for that regulatory year.

1 Introduction

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

Under the NER an insurance event is a prescribed event that applies only to transmission network service providers.⁵ An insurance event is deemed to occur in certain circumstances, including where the insurance premium amount incurred exceeds the insurance forecast by more than 1 per cent of maximum allowed revenue (MAR) in a regulatory year (materiality threshold).⁶

1.1 Who we are and our role in the process

We, the AER, exist to ensure all Australian energy consumers are better off, now and in the future. Consumers are at the heart of our work, and we focus on ensuring a secure, reliable and affordable energy future for Australia. We are the economic regulator for electricity and gas distribution and transmission services in the National Electricity Market (NEM), and our electricity-related powers and functions are set out in the National Electricity Law (NEL) and the NER.

ElectraNet's revenues are regulated by the AER through a five year transmission determination. The current transmission determination commenced on 1 July 2018 and will finish on 30 June 2023.

We are responsible for assessing pass through applications. Under the pass through provisions in the NER, a transmission business may apply to us to seek the recovery of additional costs incurred during a regulatory control period arising from predefined events, specified in either the NER or in its revenue determination.

1.2 ElectraNet's application

ElectraNet submitted that it has experienced significant increases in insurance premiums in recent years, principally because of the repricing of bushfire risk and a retraction in available market capacity. Premium costs for other classes of insurance have also increased, as insurers have responded to emerging risks, such as COVID 19 and cyber security.

The NER recognise the risk that insurance premiums may increase unexpectedly during a regulatory control period. In circumstances where these increases are 'material', the NER allows for ElectraNet to recover its actual premium costs from customers.

ElectraNet submitted that a positive change event, being an insurance event, has occurred because the cost of the premium paid or required to be paid by ElectraNet in the 2021-22

⁵ NER, cl 6A.7.3.

⁶ NER, chapter 10 (definition of 'insurance event')

regulatory year exceeds the forecast included in its maximum allowed revenue for that year by more than 1 per cent.

The relevant cost information is set out in Table 1.

Table 1 **ElectraNet's actual and allowed insurance costs 2018–23 (\$m, nominal)**

	2018-19	2019-20	2020-21	2021-22	2022-23
2018-23 insurance forecast	2.78	2.85	2.92	3.18	3.25
Actual or expected costs	2.82	3.75	4.8	6.57	TBC
Maximum allowed revenue (MAR)	305.3	312.5	322.3	333.0	347.8
Materiality threshold (1% of MAR)	3.05	3.13	3.22	3.33	3.48
Expenditure above forecast	0.1	0.9	1.9	3.40	TBC
Proposed pass-through amount	-	-	-	3.40	-

Source: ElectraNet Cost Pass Through Application, p19, 2021-22 figure adjusted in information request response.

ElectraNet claimed confidentiality over a number of the documents it submitted to us in support of its cost pass through application detailing its insurance strategies and information.⁷

This included a report from its insurance broker Aon providing further detail of the process ElectraNet has undertaken to evaluate the efficiency and prudence of different insurance options. It also included responses to an information request providing further evidence in relation to the costs incurred.

We have reviewed and accepted ElectraNet's confidentiality claims.

⁷ ElectraNet, *Attachment 1 – Confidentiality Template*, December 2021.

2 Determination

Based on our consideration of the matters set out in this decision, we determine that the material increase in ElectraNet's insurance premiums incurred in 2021-22 has resulted in a positive change event occurring.

Our determination is to approve ElectraNet's application for a positive pass through amount of \$3,395,605 million to be recovered in the 2022-23 regulatory year.

In making this determination, we have taken into account relevant factors in the NER, including:⁸

- the matters and proposals set out in ElectraNet's insurance event cost pass through application
- the incremental insurance costs in 2021-22 incurred by ElectraNet as a consequence of the positive change event
- the efficiency of ElectraNet's decisions and actions in relation to the risk of the positive change event, and
- whether the costs of the pass through event have already been factored into ElectraNet's MAR for the 2018–23 regulatory control period.

⁸ NER, cl. 6A.7.3(j).

3 Assessment and reasons for determination

The first step in our assessment is to assess whether a pass through event has occurred. A pass through event is defined as one of the following events:

- (a) a regulatory change event
- (b) a service standard event
- (c) a tax change event
- (d) an insurance event, or
- (e) any other event specified in a transmission determination as a pass through event for the determination.⁹

The NER defines an insurance event as:

An event for which the risk of its occurrence is the subject of insurance taken out by or for a Transmission Network Service Provider, for which an allowance is provided in the total revenue cap for the Transmission Network Service Provider and in respect of which:

- a. the cost of the premium paid or required to be paid by the Transmission Network Service Provider in the regulatory year in which the cost of the premium changes is higher or lower than the premium that is provided for in the maximum allowed revenue for the provider for that regulatory year by an amount of more than 1% of the maximum allowed revenue for the provider for that regulatory year...¹⁰

In our draft decision for ElectraNet's 2018–23 regulatory period, we accepted ElectraNet's proposed operating expenditure, which included a cost forecast for insurance premiums, as shown in Table 1. In our final decision, we confirmed that we accepted ElectraNet's forecast operating expenditure (updated from its initial proposal) and noted that the insurance cost pass through provisions would apply for the 2018–23 regulatory period.¹¹

In this case, the question of whether an insurance event has occurred involved an assessment of actual versus allowed insurance premium costs. ElectraNet's actual 2021-22 insurance premium of \$6.57 million exceeded its insurance forecast by \$3.4 million. ElectraNet's MAR in 2021-22 is \$332.7 million, of which 1 per cent is \$3.33 million. We are therefore satisfied that an insurance event has occurred. The cost of the insurance premium incurred by ElectraNet in 2021-22 is higher than the premium provided for in ElectraNet's MAR by an amount of \$3.4 million or 1.021 per cent.

⁹ NER, cl 6A.7.3(a1).

¹⁰ NER, chapter 10 (definition of 'insurance event')

¹¹ AER, *Final Decision, ElectraNet transmission determination, 2018 to 2023, Overview*, April 2018, pp 24 and 34.

3.1 Positive change event

If we are satisfied that a pass through event has occurred, we then determine whether the pass through event qualifies as a “positive change event”. The NER defines a positive change event for a Transmission Network Service Provider as:¹²

... a pass-through event which entails the Transmission Network Service Provider incurring materially higher costs in providing prescribed transmission services than it would have incurred but for that event...

The NER defines “materially” as follows:

For the purposes of the application of clause 6A.7.3, an event (other than a network support event) results in a Transmission Network Service Provider incurring materially higher or materially lower costs if the change in costs (as opposed to the revenue impact) that the Transmission Network Service Provider has incurred and is likely to incur in any regulatory year of a regulatory control period, as a result of that event, exceeds 1% of the annual revenue requirement for the Transmission Network Service Provider for that regulatory year.

In the case of an insurance event, the requirement for ElectraNet to incur “materially” higher costs in order for the pass through event to qualify as a positive change event duplicates the requirement in paragraph (a) of the definition of insurance event that the actual cost of insurance premiums exceed the forecast by more than 1 per cent of MAR. That is, if we are satisfied that an insurance event has occurred, then we must also be satisfied that a positive change event has occurred.

3.2 Timing of ElectraNet’s application

The NER requires ElectraNet to submit a cost pass through application to us within 90 business days of the positive change event occurring.¹³

We must then make a determination within 40 business days of ElectraNet’s application to us, or within 40 business days of receipt of a request for further information.¹⁴

ElectraNet submitted its pass through application on 16 December 2021 and we received a response to an information request on 10 February 2022. We are satisfied that ElectraNet submitted its application within 90 days of the positive change event occurring. ElectraNet has requested that the date of final placement of its insurance policies remain confidential.

3.3 Calculation of the pass through amount

In assessing a pass through application, the NER requires us to take into account a range of relevant factors, including the need to ensure that ElectraNet only recovers any actual or likely increment in costs, to the extent that such an increment is solely as a consequence of

¹² NER, chapter 10 (definition of ‘positive change event’).

¹³ NER, 6A.7.3(c).

¹⁴ NER, 6A.7.3(e).

the pass through event, and that ElectraNet does not recover costs that have or will be factored into its MAR.

Given we have determined that a positive change event has occurred, taking into account relevant factors in 6A.7.3(j) of the NER, we must determine :

- the approved pass-through amount; and
- the amount that should be passed through to Transmission Network Users in the regulatory year in which, and each regulatory year after that in which, the positive change event occurred.

We approve ElectraNet's proposed pass through amount of \$3.4 million (\$nominal) to be recovered in the 2022-23 regulatory year. This amount was identified in ElectraNet's response to our information request on 10 February 2022, which updated the amount of \$3.38 million requested in ElectraNet's initial application of 16 December 2021. As set out in Table 1, this amount exceeds 1 per cent of ElectraNet's MAR in the 2021-22 regulatory year, meeting the criteria of a positive pass through insurance event as defined in the NER.

In accordance with the NER, ElectraNet is only able to apply for recovery of insurance premiums incurred above its insurance forecast amount. For the purposes of assessing ElectraNet's cost pass through application, we have taken the insurance 'allowance' amount to be the amount included in the operating expenditure model submitted with ElectraNet's revised proposal for its 2018–23 revenue determination. Minor adjustments have been made for CPI and changes to asset base costs increasing this value from \$3.08 million to \$3.18 million (\$nominal).

Given the nature of the costs associated with an insurance event as defined in the NER, being the difference between actual and allowed costs, we are satisfied that the proposed pass through amount has been incurred solely as a consequence of the insurance event, and is not already provided for in ElectraNet's MAR.¹⁵

We reviewed the information provided as part of ElectraNet's cost pass through application, and the supporting information provided by ElectraNet's insurance broker Aon. We are satisfied, based on our review, that ElectraNet has demonstrated that it has undertaken a range of reasonable measures to ensure its insurance premium costs, and therefore the proposed pass through amount, are efficient. This included:

- close ongoing engagement with insurers to reduce costs and ensure coverage is appropriate and fit for purpose
- benchmarking their insurance cover and costs against other network providers, provided by Aon and ElectraNet; and
- consideration of alternative approaches and strategies for containing premium increases.

This reflects our assessment of the information provided in ElectraNet's application regarding its insurance renewal objectives and strategy, and the supporting report from its insurance broker Aon. ElectraNet also provided copies of invoices and a detailed reconciliation of

¹⁵ NER, cl. 6A.7.3(j)(5) and 6A.7.3(j)(6).

insurance premiums as evidence of the costs that have been incurred as a consequence of the pass-through event.

We have also reviewed similar insurance market conditions faced by other network service providers during the same period and consider that the higher insurance premiums paid by ElectraNet for the 2021-22 regulatory year are reasonable. Specifically, we have taken into account advice from our consultant Taylor Fry regarding recent changes to insurance market conditions, including significant withdrawal of global capacity for bushfire liability risks greatly reducing negotiating power of network providers. This advice was provided in the context of our assessment and acceptance of insurance step changes proposed by a number of distribution companies in 2021¹⁶. ElectraNet's insurance premium increases are broadly consistent with the increase in premiums considered reasonable by Taylor Fry for other network providers.

¹⁶ Taylor Fry, 2021, *AusNet bushfire insurance liability review on behalf of the AER*, AusNet Services - Determination 2021-26 Final Decision; Taylor Fry, 2021, *Powercor liability insurance review on behalf of the AER*, Powercor Determination 2021-26 Final Decision; Taylor Fry, 2021, *United Energy bushfire insurance liability review on behalf of the AER*, United Energy - Determination 2021-26 Final Decision.

Glossary

Term	Definition
AER	Australian Energy Regulator
MAR	Maximum Allowed Revenue
NEL	National Electricity Law
NEM	National Electricity Market
NER	National Electricity Rules
