

Determination

ElectraNet's 2022–23 Insurance Cost Pass Through

March 2023

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Overview

On 28 October 2022, ElectraNet submitted a cost pass-through application for an insurance event, seeking to recover incremental revenue of \$5.32 million in relation to an increase in its insurance premiums for the 2022–23 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 9 November 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 2022–23 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 \$5.32 million (\$nominal) to be recovered in 2023–24.

We estimate that the approved cost pass through amount will add approximately \$3 (\$nominal) to residential consumer bills in the 2023–24 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 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 defined as occurring 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.⁷

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 2022–23

⁵ NER, cl 6A.7.3.

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

⁷ ElectraNet, ElectraNet 2022-23 Insurance Pass Through Application Final – Public, 28 October 2022, p. 5.

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	3.15	3.45
Actual or expected costs	2.82	3.75	4.8	6.53	8.78
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	3.38	5.32
Proposed pass-through amount	–	–	–	–	5.32

Source: ElectraNet - Cost pass through application - 2022–23 insurance costs - 28 October 2022, p17.

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.⁸

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 cost breakdowns and ElectraNet's calculations with evidence in relation to the costs incurred.

We have reviewed and accepted ElectraNet's confidentiality claims.

⁸ However, ElectraNet provided a public version of its application, which is available on our website [here](#).

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 2022–23 has resulted in a positive change event occurring.

Our determination is to approve ElectraNet’s application for a positive pass through amount of \$5,323,035 million to be recovered in the 2023–24 regulatory year.

In making this determination, we have taken into account relevant factors in the NER, including:⁹

- the matters and proposals set out in ElectraNet’s insurance event cost pass through application
- the incremental insurance costs in 2022–23 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.

⁹ 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.¹⁰

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;*
- b. *the risk eventuates and, as a consequence, the Transmission Network Service Provider incurs or will incur all or part of a deductible where the amount so incurred or to be so incurred in a regulatory year is higher or lower than the allowance for the deductible (if any) 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;*
- c. *insurance becomes unavailable to the Transmission Network Service Provider; or*
- d. *insurance becomes available to the Transmission Network Service Provider on terms materially different to those existing as at the time the revenue determination was made (other than as a result of any act or omission of the provider which is inconsistent with good electricity industry practice).¹¹*

In our draft decision for ElectraNet's 2018–23 regulatory period, we accepted ElectraNet's proposed operating expenditure, which included a total cost forecast for insurance premiums,

¹⁰ NER, cl 6A.7.3(a1).

¹¹ NER, chapter 10 (definition of 'insurance event')

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.¹² For the purposes of interpreting the insurance event definition, we consider ElectraNet’s proposal to define the insurance premium allowance for the 2018–23 regulatory period as the amount proposed in its regulatory proposal and accepted by the AER is reasonable.

We have also considered whether the ‘cost of the premium paid or required to be paid’ referred to in the insurance event definition can reasonably be interpreted as meaning the total of insurance premiums paid by ElectraNet across all categories of insurance in a regulatory year. Generally, in accordance with the provisions relating to interpretation in the NEL, the starting position is that words in the singular (e.g. ‘event’ or ‘premium’) include the plural, however that may be displaced by a contrary intention appearing in the NER.

In response to our information request, ElectraNet provided legal opinion which supported its interpretation of the insurance event definition, and advised that:¹³

- ElectraNet’s insurance cost has increased by 154% relative to the allowance in 2022-23
- ElectraNet’s insurance costs now sit \$5.32 million over the allowance which exceeds the 1% MAR threshold of \$3.48 million by a significant margin
- despite the extreme volatility in the insurance market and unprecedented increase in premiums over the course of the current regulatory period, ElectraNet would not exceed the 1% MAR threshold at an individual premium level on any of its insurance policies;
- individually, premiums would have had to increase by a factor of between 3 and over 8,200 times in order to exceed the 1% MAR threshold.

ElectraNet submitted that interpretation of the insurance event definition as relating to a single category of insurance would render the pass through mechanism of little or no practical effect. This would be contrary to the purpose of the cost pass through framework.

Having regard to the information provided by ElectraNet, we consider that the definition of the insurance event should be interpreted in a manner that allows it to have practical effect in ElectraNet’s existing commercial circumstances. However, we note that the approach taken to insurance policies in this context should not necessarily be taken as precedent for other matters where the singular and plural issue arises – the decision in this case rests on the commercial realities and the evidence provided by ElectraNet.

The question of whether an insurance event has occurred in this case therefore involves an assessment of actual versus allowed insurance premium costs in the 2022-23 regulatory year. ElectraNet’s actual 2022-23 insurance premium of \$8.78 million exceeded its insurance forecast by \$5.32 million. ElectraNet’s MAR (smoothed) in 2022-23 is \$356.98 million, of which 1 per cent is \$3.57 million.¹⁴ We are therefore satisfied that an insurance event has

¹² AER, *Final Decision, ElectraNet transmission determination, 2018 to 2023, Overview*, April 2018, pp. 24 and 34.

¹³ ElectraNet, *Response to notice under clause 6A.7.3(e1) of the NER*, 10 February 2023, p. 3.

¹⁴ The MAR of \$356.98 million (nominal, smoothed) is slightly different from the amount of \$347.8 million reflected in ElectraNet’s cost pass through application (see Table 1 above). This is because, in our review, we have relied on the Post Tax Revenue Model update to reflect updated ElectraNet’s return on debt for 2022-23.

occurred. The cost of the insurance premium incurred by ElectraNet in 2022–23 is higher than the premium provided for in ElectraNet’s MAR by an amount of \$5.32 million or 1.5%.

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:¹⁵

... 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.¹⁶

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.¹⁷

ElectraNet submitted its pass through application on 28 October 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.

On 23 December 2022, we sought additional information from ElectraNet in order to make our determination, in accordance with clause 6A.7.3(e1) of the NER. ElectraNet provided its

¹⁵ NER, chapter 10 (definition of ‘positive change event’).

¹⁶ NER, 6A.7.3(c).

¹⁷ NER, 6A.7.3(e).

response on 10 February 2023. The timeframe for the AER to make its determination was thereby extended to 7 April 2023, in accordance with clause 6A.7.3(e) of the NER.

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 incremental costs, to the extent that such an increment is solely as a consequence of 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 \$5.32 million (\$nominal) to be recovered in the 2023–24 regulatory year. This amount was identified in ElectraNet’s application of 28 October 2022. As set out in Table 1, this amount exceeds 1 per cent of ElectraNet’s MAR in the 2022–23 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.

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.¹⁸

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

¹⁸ NER, cl. 6A.7.3(j)(5) and 6A.7.3(j)(6).

- consideration of alternative approaches and strategies for containing premium increases.

ElectraNet also provided copies of invoices and a detailed reconciliation of 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 2022–23 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 electricity transmission and distribution companies in 2021 and 2022¹⁹. ElectraNet's insurance premium increases are broadly consistent with the increase in premiums considered reasonable by Taylor Fry for other network providers.

¹⁹ Taylor Fry, *AER - ElectraNet 2023–28 – Draft decision - Insurance market consultant report - ElectraNet - Public summary– PUBLIC*, June 2022; Taylor Fry, *AER - Transgrid 2023–28 - Draft decision - Insurance market consultant report – PUBLIC*, June 2022; Taylor Fry, *AusNet bushfire insurance liability review on behalf of the AER, AusNet Services - Determination 2021–26 Final Decision*, April 2021; Taylor Fry, *Powercor liability insurance review on behalf of the AER, Powercor Determination 2021–26 Final Decision*, April 2021; Taylor Fry, *United Energy bushfire insurance liability review on behalf of the AER, United Energy - Determination 2021–26 Final Decision*, April 2021,.

Glossary

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