Ausgrid Submission

AER Insurance coverage event application consultation paper

October 2020

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24-28 Campbell St
Sydney NSW 2000
All mail to
GPO Box 4009
Sydney NSW 2001
T +61 2 131 525
ausgrid.com.au

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

Dear Mr Roberts

Ausgrid welcomes the opportunity to provide this submission to the AER's consultation paper on the application of the insurance coverage pass-through event. We appreciate the AER initiating the preparation of a guidance note in response to changing insurance market conditions.

We agree with the AER's observations regarding the impact of the recent bushfires on the insurance market. Since 2019, we have observed rising insurance premiums and withdrawn capacity for network service providers (NSPs) seeking insurance coverage. To mitigate the risk of rising general liability (including bushfire) premiums and to lock in capacity offered by insurers, we renewed our insurance earlier than usual this year. Details of our recent insurance renewal experience can be found in confidential Attachment A to this submission.

We support changing the current insurance cap pass-through framework to an insurance coverage pass-through approach. This change should deliver a better outcome for both customers and NSPs. In Ausgrid's context, this means applying the 'least cost option', i.e. only paying a reasonable premium in the commercial insurance market for the risk transfer from Ausgrid to the insurance underwriter, rather than paying 'whatever the cost' to fulfil all the insurance layers of Ausgrid's bushfire insurance limit.

The assessment of an efficient level of insurance coverage should be undertaken regarding the specific circumstances of each NSP. There is evidence from bushfire modelling analysis initiated by Ausgrid that our bushfire risk is much lower than that of our peers. This is because Ausgrid's network is mostly in the densely-populated Sydney area. For this reason, Ausgrid is of the view that obtaining insurance coverage for its existing bushfire insurance limit should be managed based on the 'least cost option'.

We support the development of a guidance note that provides clarity to NSPs on how to determine a level of insurance that an efficient and prudent NSP would obtain, or would have sought to obtain, in respect of the type of insurance triggering events, such as bushfires.

Our submission provides views on the various factors that should be considered when the AER assesses an appropriate level of insurance for each NSP to manage its bushfire and other risks, as well as the information that should be considered as part of that process.

If you would like to discuss our submission in more detail, please contact [redacted]

Yours sincerely

Rob Amphlett Lewis
Chief Customer Officer

Consultation questions

1. **Are there any other key elements that stakeholders believe should be included as part of our assessment process? Please detail what these are and why should they be considered. This could include any aspects which Network Service Providers consider are specific to their business circumstances and operating environment**

We agree with the AER's view that the assessment process should consider an NSP's decisions relating to the risks and costs associated with low probability, high severity (catastrophic) set of circumstances. Managing bushfire risk does vary between NSPs and specific circumstances and associated factors should be considered as part of the assessment process.

Outlined in the table below are the various factors mentioned in the consultation paper and its impact on Ausgrid:

Factor	Impact on Ausgrid
Risk tolerance levels	Ausgrid has maintained a low risk tolerance when obtaining insurance and its high insurance limits have remained unchanged. Ausgrid maintains high deductibles (i.e. excess), comparable to its peers. We have given due consideration to whether the risk tolerance of these deductibles should be increased which would provide significant premium savings as the primary layer is the most expensive insurance layer. Another risk tolerance level that Ausgrid is recently exploring is 'self-insurance' on some of the layers of its bushfire insurance coverage where premiums are not prudent.
Insurance policy structure	Ausgrid's general liability (including bushfire) insurance limit has remained unchanged. We have never 'self-insured' any layers in our bushfire insurance limit. Given the volatile commercial insurance market and the significant premium increases, Ausgrid is considering whether to 'self-insure' layers in next year's renewal, which will depend on the premiums. Regarding ISR (also known as property insurance), Ausgrid is not at this stage considering reducing its limit or increasing the deductible, as the premium increases in the property insurance market in 2020 have been in the order of 20-30% and not as volatile as the general liability insurance market Regarding Directors and Officers (D&O) insurance, due to increasing shareholder class actions, the D&O insurance market is highly volatile and seeing premium volatility as high as 400% increases.
Past liability claims	Ausgrid has not made any bushfire claims. Its largest loss was less than the $10 million deductable (excess) and was self-incurred in 1990.
Mitigation practice	Ausgrid performs extensive maintenance and bushfire season preparation activities to minimise the risk of initiating a bushfire. These activities include asset defect and vegetation reviews from aerial LiDAR and photographic surveys of power lines for any required remedial action prior to each bushfire season. Resource requirements for this activity is significant.
Operating environment	Ausgrid's network area includes rural, semi-rural and urban areas with most powerlines overhead in rural areas and transitioning to underground in the densest areas. As Ausgrid is located on the eastern coast of Australia there is a large amount of vegetation near power lines and approaching customer premises.

Factor	Impact on Ausgrid
	Most customers are in densely populated areas such as Sydney, Newcastle and Central Coast areas that are within close proximity of fire brigade services. The population density of Ausgrid's area impacts on Ausgrid's bushfire risk in both a positive and negative way. i.e. dense areas have low bushfire risk, however bushland abutting dense urban areas increases the potential consequences were a bushfire to start.
Prevailing insurance market	Ausgrid renewed early its bushfire insurance limit with the commercial insurance market at a significant premium from previous years and is likely to see further increases in coming years.

2. Within each of the relevant key elements, what specific issues, considerations, analysis and information should be included as a part of our assessment process? Please set these out in detail and explain why they should be considered?

We refer to our response to Question 1 on the specific issues, considerations of the key elements that should form part of the AER's assessment process.

Outlined in the table below are Ausgrid's responses to whether the information below would be beneficial to assisting the AER's assessment of the right level of insurance that each NSP should have to manage its risk with either commercial insurance or self-insurance.

Issue to be considered	Part of assessment process
Maximum foreseeable or probable loss assessment	Yes, this issue should be considered by the AER. Advice from an independent party about maximum foreseeable or probable loss should form part of the assessment.
Relevant and expert information of the insurance liability market (trends and movements in premiums and coverage) and its effort to seek appropriate cover	Yes, relevant and expert information should form part of the AER's assessment. Each NSP can also provide history of premiums and coverage to inform the AER's assessment.
The rationale behind how an NSP chooses to insure against an event and the level of cover obtained	Yes, this issue should be included in the AER's assessment. Given the significant premium increases in the commercial insurance market, Ausgrid is now considering a range of insurance options, including increasing its deductible or reducing its insurance limits. However, Ausgrid is cautious of implementing these options without certainty that if a catastrophic event did occur and exposed Ausgrid to a significant loss, that an insurance coverage pass-through would be approved.
Independent report or certification from an insurance expert that details the NSP's insurance cover is appropriate	Certification sourced from an independent insurance expert should satisfy the requirement to determine an appropriate level of insurance and should be considered as part of the AER's assessment.
Whether the NSP has undertaken meaningful consumer engagement about its insurance cover	Time constraints with the insurance renewal process may not allow for sufficient time to engage with consumer groups following feedback from insurers of the premiums proposed (which is only made within a week of renewal) or withdrawal of capacity from the market during the renewal process. However, NSPs should engage with customers about the allocation of risk between the NSP and customers during the development of a NSP's regulatory determination.
Whether the NSP has explored the availability of other risk mitigating insurance products	Yes, the AER should consider what other insurance products have been considered and why or why not they have become part of the insurance portfolio. For example, a form of risk mitigating product is to use a captive (either as a wholly-owned subsidiary or a as "rent a captive", known as a protected cell company (**PCC**)). Other forms of risk mitigating insurance products may be to increase the deductible, which is effectively carrying that risk up to the deductible amount. Another risk mitigating option is to also reduce the insurance limit or only insure for a "selected region" – e.g. Ausgrid to only insure for bushfire risk in the Hunter region rather than in the CBD.

3. Is there any other specific information or processes that stakeholders see as crucial, and consistent with the National Electricity Rules, that we should consider in assessing how low probability, high severity risks and costs should be managed between a NSP's insurance program and its customers (to inform whether an NSP has established a prudent and efficient level of insurance)?

It is worth having regard to the Bushfire Factsheet that was issued in January 2020 by Energy Networks Australia. The Factsheet outlined that whilst the probability of bushfires ignited by electricity is very low (only 2.7% of bushfires are caused by electrical faults), once the bushfire has started, it does carry a high severity risk and costs as it has the potential to burn large areas.

The Factsheet explains that NSPs continually inspect vegetation clearance rates and the various technology solutions used by NSPs as forms of mitigating this severe risk.

The specific information that should be requested by the AER from each NSP is their bushfire preparedness program, vegetation maintenance program and any technical solutions that have been implemented to mitigate any bushfire risk.

For example, in potential bushfire impact areas, Ausgrid conducts:

- Vegetation monitoring and trimming to maintain minimum clearance from powerlines;
- Annual light detection and ranging scanning for vegetation clearance by helicopter;
- Detailed assessments using drones of bushfire impacted areas (identified using satellite imagery);
- Electrical asset inspection and maintenance regime (including high definition photography);
- Additional training for hazard tree identification by pole and line inspectors;
- Annual inspections of private mains; and
- Annual inspections of all non-insulated services wire connections

Annual audit of all high voltage customers installation safety plans. The probability of a first start by an NSP and the value of bushfire consequence should be an integral part of an NSPs assessment of whether it is prudent to provide coverage by insurance market products. This should be considered to determine if the benefit and potential risk mitigation of an insurance product and subsequent premium outweighs the benefit to customers.

4. Do stakeholders see benefits in us having annual information provision process for NSPs to inform us of material changes relating to its insurance position? Please detail what value/advantages and costs/disadvantages you consider such an information process would provide for the AER, NSPs and other stakeholders. Please also detail what information you consider could be provided and outline your views about the form and timing of any process. We would also be interested to understand whether NSPs are likely to use an annual opt in process?

Ausgrid is of the view that sufficient disclosures are already made for the annual insurance operating expenditure as part of the annual Regulatory Information Notices (RIN).

The insurance operating expenditure split between Standard Control Services (SCS) and Alternative Control Services (ACS) is disclosed in the Annual Reporting RIN 8.4 Opex and the Economic Benchmarking RIN 3.2 Opex.

5. **Do stakeholders see benefits in us collecting insurance information for benchmarking purposes in the annual information provision process? Please detail what value/advantages and costs/disadvantages you consider this would provide for the AER, NSP and other stakeholders. This information could be captured as part of the annual Regulatory Information Notice (RIN) or a separate annual opt in process**

Ausgrid does not see any benefits in the AER collecting annual insurance costs for each NSP through the annual RIN process or a separate annual opt in process. Each NSP's network and risk profile are different and therefore the premium cost for transferring this risk to an insurance provider will vary.

For example, Ausgrid has a lower bushfire risk profile than its NSW peers given its network area is in a densely populated area that is within close proximity of fire brigade services, so it is expected that Ausgrid's bushfire insurance premiums would be lower than its NSW peers. Additionally, Ausgrid's property insurance is likely to be higher than its peers due to the larger and higher value buildings required in the Sydney CBD and surrounds. The ability to adequately benchmark the insurance information would require a significant number of operating environment factors.

As mentioned above, the insurance operating expenditure split between SCS and ACS is disclosed in the Annual Reporting RIN 8.4 Opex and the Economic Benchmarking RIN 3.2 Opex. Outlined in the table below is the last three years insurance operating expenditure disclosures made in the Annual Reporting RIN 8.4 Opex and the percentage increases.

Year	Total	Standard Control Services	Alternative Control Services	% Increase /(decrease) from prior year total
2020	5,628,241	5,183,495	444,746	15.8%
2019	4,861,681	4,599,990	261,691	(2.6%)
2018	4,992,167	4,744,085	248,082	(5.5%)

6. **What processes are in place (or planned) by NSPs to manage circumstances where costs are incurred beyond policy limits or there are gap(s) in their insurance cover, and they face potential third-party claims arising from bushfires? How do NSPs manage or plan to manage their exposures in cost effective ways under these circumstances? Given that an insurance coverage pass-through event is in place, how do stakeholders think that the incentives of NSPs to be efficient and cost effective are affected in their efforts to minimize their exposure above the insurance cover limit or gaps in their insurance policies? How can we incentivize an NSP to be prudent and efficient under these circumstances?**

Ausgrid has a Risk Appetite Statement where environmental risks, such as bushfire risk, is characterised as 'risk-sensitive', i.e. limited risk taking. Confidential Attachment A to this submission outlines Ausgrid's recent experience in managing bushfire risk.

The risk mitigation activities undertaken to minimise bushfire risk have to date, been effective in avoiding the need to claim against an insurance coverage. This outcome is in line with Ausgrid's risk appetite and aligns with the incentives an NSP already must operate in a prudent and efficient manner. These incentives are present in the expenditure, adverse publicity and customer hardship outcomes that would be experienced in the event of a catastrophic fire.

Ausgrid continually improves its asset management strategies and maintenance practices utilising the latest information available, techniques and technologies. This includes CEO led lessons learnt

workshop and subsequent actions following each bushfire season. The key highlights and changes from these workshops include:

- revised vegetation management standard;
- new vegetation management contracts;
- new pre-bushfire season inspection (with Light Detection and Ranging (LiDAR), imagery and defect assessment);
- enhanced bushfire ignition and impact modelling;
- hazard tree identification training; and
- independent external audits of Ausgrid's Asset Management System, Bushfire Preparation and Electrical Safety Management System for Bushfire Risk Management

Revised vegetation management standard

Ausgrid's network standard Vegetation Management (NS179) was revised and re-issued with improvements to clarify Ausgrid's clearance requirements in varying geographic areas and for different construction types to assist in supporting the execution of all vegetation management contracts.

New vegetation management contract

A new set of vegetation management contracts have been executed with three of Ausgrid's existing vegetation management providers. These three contractors all have bushfire insurance up to a certain limit.

The new contracts include more favourable terms and conditions to operate the contract including the technical specification with improved data exchange requirements to facilitate accurate information exchange and ensure adherence to the original intent of the network standard. The contract allows Ausgrid to better align the management of vegetation with internal processes through the revised data specification requirements.

New pre-bushfire season inspection (LiDAR, imagery and defect assessment) contract

A new pre-bushfire season inspection contract, including LiDAR, imagery and defect assessment, has been executed. The new contract includes improved data capture deliverables with more control and incentive for achieving improved delivery timeframes. This allows Ausgrid to better identify, assess and prioritise asset and vegetation defects.

Enhanced fire behaviour modelling

Ausgrid is analysing the information from a recent industry funded report on bushfire consequences. Ausgrid commissioned its insurance broker to undertake a collaborative study with The University of Melbourne and Reask, an independent risk consultant, a bushfire behaviour modelling and consequences report specific to the Ausgrid network.

Hazard tree identification training

To improve the identification of vegetation outside of clearances that has a risk of impacting the network, Ausgrid has implemented improved hazard tree identification training for inspectors and auditors.

Asset Management System Surveillance Audit

Following from the certification of Ausgrid to the international standard for Asset Management Systems a surveillance audit was conducted and found Ausgrid continues to be certified to ISO 55001:2014. This led to further improvements in Ausgrid's Asset Management System

documentation of its governance and procedures. Actions are being tracked to provide visibility for management of progress for completion and ensuring timely resolution.

The NSW Independent Pricing and Regulatory Tribunal (IPART) directed independent audit of Ausgrid's Electrical Safety Management System (ENSMS) – Bushfire Risk Management:

Ausgrid was directed by its regulatory license administrator to undertake an independent audit of its ENSMS in relation to Bushfire Risk Management in December 2019. The audit found Ausgrid's safety management system had, in all material respects, been effectively implemented as related to the scope of the audit.

Independent review of bushfire preparations for 2019/20 bushfire season

Ausgrid appointed an independent industry expert to conduct a high-level overview of its bushfire related strategies, plans, practices, and task completion to assess the businesses' overall level of preparedness leading into the 2019/20 summer bushfire season.

Overall, the review found that Ausgrid understood the risk and appeared well prepared for the bushfire season with regards to defect rectification prior to commencement of the early declared bushfire prone areas.

7. We understand that the recent volatility in the liability insurance market have been having a major impact on electricity distribution and transmission businesses, do gas businesses face similar impacts?

N/A


Thank you
Ausgrid