



# Pass Through Event Proposal

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## 1. Introduction

ElectraNet is submitting this proposal in line with the transitional arrangements included in the National Electricity Rules (the Rules), following from the AEMC's Rule Determination in relation to the National Electricity Amendment (Cost pass through arrangements for network service providers) Rule 2012.<sup>1</sup>

Clause 11.49.4 of the Rules allows ElectraNet to submit to the AER (not later than 30 days from the commencement date)<sup>2</sup> a proposal as to the events that should be defined as pass through events under clause 6A.7.3(a1)(5) for the purposes of its Revenue Proposal for the next regulatory control period, having regard to the nominated pass through considerations (as defined in the Rules).

ElectraNet proposes that the following three pass through events be approved as part of the AER's revenue determination for ElectraNet for the 2013/14-2017/18 regulatory control period:

- a terrorism event;
- a natural disaster event; and
- an insurance cap event.

ElectraNet has had regard to the nominated pass through event considerations in putting forward these proposed pass through events. ElectraNet notes that the nominated pass through event considerations closely reflect the assessment criteria previously adopted by the AER in assessing nominated cost pass through events for the Distribution Network Service Providers (DNSPs). ElectraNet further notes the AEMC's view that the nominated pass through event considerations are intended to be high level considerations rather than to operate individually as an explicit basis to accept or reject a pass through event, as different pass through events will require different weight to be given to different considerations.<sup>3</sup> ElectraNet also notes the AEMC's comments that the nominated pass through considerations 'do not stipulate any specific action'<sup>4</sup> and that 'these are considerations only, therefore the [Network Service Provider] and the [Australian Energy Regulator] can come to a mutual understanding that a pass through event is inconsistent with the factors for consideration, but may still be the more efficient mechanism'.<sup>5</sup>

The remainder of this application discusses each of the three proposed pass through events in turn.

ElectraNet has already lodged its Transmission Network Revenue Proposal with the Australian Energy Regulator (AER).<sup>6</sup> The Revenue Proposal was necessarily based on the Rules in force at the time of lodgement, which did not permit ElectraNet to propose

<sup>1</sup> National Electricity Amendment (Cost pass through arrangements for Network Service Providers) Rule 2012 No.4.

<sup>2</sup> The commencement date for the National Electricity Amendment Rule was 2 August 2012. 30 days from this commencement date is 1 September 2012.

<sup>3</sup> AEMC, Rule Determination, National Electricity Amendment (Cost pass through arrangements for network service providers) Rule 2012, 2 August 2012, p. 11.

<sup>4</sup> Op cit, p. 19.

<sup>5</sup> Op cit, p. 20.

<sup>6</sup> ElectraNet's Revenue Proposal was lodged with the AER on 31 May 2012.

additional pass through events. As a consequence, ElectraNet incorporated within the self-insurance allowance contained in the Revenue Proposal an amount reflecting compensation for the risk it expected to bear in relation to above insurance limit risk for bushfire liability. Acceptance by the AER of the proposed insurance cap event for the 2013/14-2017/18 period would result in this risk no longer needing to be self-insured. This proposal therefore also presents a revised self-insurance allowance for the 2013/14-2017/18 regulatory control period, contingent on acceptance by the AER of the proposed pass through events in this application. Further details of the proposed change in the self-insurance allowance are included in Appendix A. An update of the earlier self-insurance risk quantification undertaken by Aon, reflecting the impact of the proposed pass through events, is presented in Appendix B.

## 2. Terrorism event

### 2.1 Proposed definition

ElectraNet proposes a 'terrorism event' as a pass through event for the 2013/14-2017/18 regulatory control period, defined as follows:

An act (including, but not limited to, the use of force or violence or the threat of force or violence) of any person or group of persons (whether acting alone or on behalf of or in connection with any organisation or government), which from its nature or context is done for, or in connection with, political, religious, ideological, ethnic or similar purposes or reasons (including the intention to influence or intimidate any government and/or put the public, or any section of the public, in fear) and which *materially* increases the costs to ElectraNet of providing *prescribed transmission services*.

The AEMC's amendment to the Rules<sup>7</sup> has removed a 'terrorism event' as a prescribed pass through event in the Rules, applicable to all Transmission Network Service Providers (TNSPs). The transitional amendments (clause 11.39.3) provide for a 'terrorism event' to remain a pass through event for all Network Service Providers (NSPs) until the end of their current regulatory control period. For ElectraNet this means that for the upcoming 2013/14-2017/18 regulatory control period a 'terrorism event' will no longer automatically be a cost pass through event under the Rules.

ElectraNet therefore proposes that a terrorism event be included as a pass through event in the AER's revenue determination for ElectraNet for the 2013/14-2017/18 regulatory control period. ElectraNet's proposed definition of this event is the same as the definition previously included in the Rules, amended only insofar as to make it applicable to ElectraNet directly, rather than all NSPs.

Under the proposed definition, the terrorism event must 'materially' increase the costs incurred by ElectraNet, in order to qualify as a pass through event. 'Materially' is defined in the Rules as exceeding 1% of the TNSP's Maximum Allowed Revenue (MAR) for that regulatory year.

### 2.2 Nominated pass through considerations

ElectraNet considers that including a terrorism event, as defined above, as a pass through event represents the most appropriate means of managing the risk that such an event occurs and results in a material increase in costs for ElectraNet in the forthcoming regulatory control period. In relation to the nominated pass through event considerations, ElectraNet notes the following:

- The proposed terrorism event is not covered by a category of pass through event specified in clause 6A.7.3(a1)(1) to (4).
- The nature and type of event can be clearly identified at the time that the AER makes its determination for ElectraNet, as evidenced by the proposed definition (which was previously incorporated into the Rules).
- The extent to which ElectraNet can reasonably prevent a terrorism event from occurring and/or can substantially mitigate the cost impact of such an event is

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<sup>7</sup> National Electricity Amendment (Cost pass through arrangements for Network Service Providers) Rule 2012 No.4.

limited. ElectraNet notes that the meshed design of the transmission network and the dual path overlaid telecommunication network (to support operational control and electrical system protection) means that there is no single point of failure. ElectraNet believes that it has additional prudent measures in place to try to prevent a terrorism event occurring and/or to mitigate the cost impact of such an event. These measures include:

- Maintaining holdings of critical common spares, together with emergency deployment plans.
  - Installation underway at selected critical sites of substation integrated perimeter security systems, together with video surveillance.
  - Upgraded substation perimeter security fencing installation underway for all sites, with critical sites already completed.
  - External hardening refit of doors and window penetrations, currently underway at substation control buildings.
  - Upgraded substation control building fire and entry security.
  - Active participation in the South Australian government's Engineering Functional Service Group & Plan, pursuant to the Emergency Management Act 2004 and South Australia State Emergency Management Plan, to enable the coordination of the protection, restoration and maintenance of essential services infrastructure.
- ElectraNet also has commercial insurance cover under its Industrial Special Risk Policy which would be triggered by a terrorism act which falls under the 2003 Terrorism Insurance Act and which is subject to a Ministerial declaration. In relation to cyber terrorism, the insurance market is still developing, and obtaining insurance coverage remains difficult.
  - The potential magnitude of the cost impact of a terrorism event means that it is a risk which ElectraNet believes cannot be credibly self-insured. Moreover, the relative infrequency of such events means that there is a lack of data on which to base a reliable calculation of a self-insurance premium.<sup>8</sup>

ElectraNet notes the AEMC's comment that the removal of the terrorism event from the list of prescribed pass through events does not imply that these types of events should not be treated as pass through events, but only that the decision should be made as part of the AER's determination process, considering the circumstances of each NSP, rather than prescribed in the Rules.<sup>9</sup>

## **2.3 Implications for insurance and self-insurance allowances**

As noted above, ElectraNet does currently have some commercial insurance coverage in relation to terrorism events. ElectraNet considers that such cover represents a prudent and efficient means of mitigating the cost impact of such an event, albeit that such mitigation is limited due to the developing nature of the insurance market in this area. ElectraNet therefore considers that it is prudent for it to continue to maintain this insurance cover, notwithstanding the inclusion of a terrorism event as a pass through

<sup>8</sup> See Aon Self Insurance Risk Quantification, Revised Report – August 2012, p. 28.

<sup>9</sup> AEMC, Rule Determination, National Electricity Amendment (Cost pass through arrangements for network service providers) Rule 2012, 2 August 2012, p. 11.

event. Where a terrorism event occurred which enabled an existing commercial policy to be called upon, this would reduce the costs incurred directly by ElectraNet and therefore reduce the amount claimed under any cost pass through application, in line with 6A.7.3(j)(2). ElectraNet is not therefore proposing any change to the insurance premiums included in its Revenue Proposal.

At the time at which ElectraNet submitted its Revenue Proposal to the AER, a terrorism event was included as a prescribed pass through event in the Rules. As a consequence, this was not a risk for which ElectraNet was self-insuring, and there was no allowance made within the proposed self-insurance amount relating to self-insurance for terrorism events.

Acceptance by the AER of a terrorism event as a cost pass-through event for the 2013/14-2017/18 regulatory control period would not therefore have any implication for the self-insurance allowance included for the period. However, if the AER were to determine that a terrorism event should *not* be included as a pass-through event in its determination for the 2013/14-2017/18 period, then the consequence would be that ElectraNet would face a risk exposure in relation to terrorism events not covered by its commercial insurance, for which it would be effectively self-insuring. In this circumstance ElectraNet reserves the right to amend its proposed self-insurance allowance to reflect this self-insurance. However, as noted above, the difficulty of calculating a reliable self-insurance amount in relation to terrorism events is one of the considerations which supports acceptance of a terrorism event as a pass through event.



### 3. Natural disaster event

#### 3.1 Proposed definition

ElectraNet proposes a 'natural disaster event' as a pass through event for the 2013/14-2017/18 regulatory control period, defined as follows:

'Any flood, fire, earthquake or other natural disaster beyond the reasonable control of ElectraNet which *materially* increases the costs to ElectraNet of providing *prescribed transmission services*.'

This additional pass through event clearly captures a key category of uncertain, potentially high cost events outside of ElectraNet's reasonable control. Natural disaster events typically result in TNSPs incurring substantial costs, including those arising from property damage to towers and lines.

A 'natural disaster event' has been approved by the AER for the Victorian DNSPs<sup>10</sup> and in its recent determination for Aurora in Tasmania.<sup>11</sup> The AER has also been clear that natural disasters fall within the scope of the more general 'General Nominated Pass Through Event' which it earlier approved for the DNSPs in South Australia, Queensland, NSW and the ACT.<sup>12</sup>

ElectraNet's proposed definition of a 'natural disaster event' is based upon the pass through event approved by the AER for the Victorian DNSPs and for Aurora, with the following modifications:

- the requirement for the flood, fire or earthquake to be 'major' has been removed, as such an event will be major if it 'materially' increases the costs to ElectraNet. As noted earlier, 'materially' is defined under the Rules as exceeding 1% of the TNSP's MAR for that regulatory year;
- the event is required to be beyond the 'reasonable' control of ElectraNet;
- the exclusion of events for which external or self-insurance has been included in ElectraNet's forecast operating expenditure has been removed, as this could be interpreted as precluding a pass through where the event is covered by any insurance even if that insurance is not sufficient to cover the costs arising from that event (e.g. as where the natural disaster was of an unprecedented magnitude). The existence of external insurance and/or self-insurance, and any changes made by ElectraNet in comparison with the amounts included in forecast operating expenditure is more properly a matter that the AER must take into account in approving the pass through amount (and which is permitted under clause 6A.7.3(j)(3)); and
- the requirement that the natural disaster occur during the relevant regulatory control period has been removed.

<sup>10</sup> AER, *Victorian electricity distribution network service providers Distribution determination 2011–2015, Draft Decision*, June 2010. p. 726-728

<sup>11</sup> AER, *Aurora 2012-2017 Draft Distribution Determination*, p. 39.

<sup>12</sup> AER, *Victorian electricity distribution network service providers Distribution determination 2011–2015, Final Decision*, October 2010, p. 746.



ElectraNet notes that the proposed definition of ‘natural disaster event’, together with the requirement under the cost pass through provisions for NSPs to make a single pass through application within 90 business days (NER 6A.7.3(c)), means that this event can primarily be expected to cover the capital cost consequences of a natural disaster (i.e., damage to towers and wires).

In addition, a substantial proportion of the potential costs associated with a natural disaster are likely to arise from third party liability claims, such as where a bushfire triggers fire-related liability claims relating to ElectraNet’s business operations. Such claims typically occur more than 90 business days after the occurrence of the natural disaster. Moreover, the costs of such claims typically only crystallise when the claims are made, and cannot easily be estimated on a prospective basis. ElectraNet considers that the cost impact of these third party claims are more appropriately addressed by the inclusion of a separate ‘insurance cap’ pass through event in the determination (as discussed below), rather than through the definition of a ‘natural disaster’ event. However this means that these two proposed pass through events (i.e. ‘natural disaster event’ and ‘insurance cap event’) are complementary and are proposed as a package. In the event that the AER were to approve the ‘natural disaster event’ but not the ‘insurance cap event’, then ElectraNet considers that the definition of the natural disaster event would need to be amended in order to also capture third party liability claims related to the natural disaster.

### 3.2 Nominated pass through considerations

In relation to the nominated cost pass-through considerations, ElectraNet notes the following:

- The proposed natural disaster event is not covered by a category of pass through event specified in clause 6A.7.3(a1)(1) to (4). In addition, the AER made the following observation in relation to Aurora’s proposal for a natural disaster pass through event: ‘The AER recognises that there is some potential overlap with other allowances or events such as liability above insurance cap. However it will consider any specific cost claim under the most appropriate event and ensure it is not double-counted’.<sup>13</sup>
- The nature and type of event can be clearly identified at the time of this determination, as recognised by the AER in its earlier determinations;<sup>14</sup>
- ElectraNet cannot prevent a natural disaster from occurring. ElectraNet believes that it has a range of prudent preventative measures in place in relation to potential natural disasters. These include the following measures:
  - Fire start management (transmission lines): Full engineering grade aerial survey and audit conducted of vegetation clearance to transmission line assets in high bushfire risk zones, with repeat surveys/audits scheduled on a cyclic basis; upgraded annual pre- and mid-bushfire season aerial inspection programmes, focussing specifically on potential fire-start asset defects; non-destructive *in situ* testing of transmission line insulation components for end-of-life criteria; cyclic vegetation clearance programme

<sup>13</sup> AER, *Aurora 2012-2017 Draft Distribution Determination*, p. 39.

<sup>14</sup> For example: AER, *Victorian electricity distribution network service providers Distribution determination 2011–2015, Final Decision*, October 2010, p. 745 & AER, *Distribution Determination Aurora Energy Pty Ltd 2012–13 to 2016–17*, November 2011, Draft Decision, p. 285.

and auditing according to the Electricity (Principles of Vegetation Clearance) Regulations 2010.

- Fire start management (substations): Full substation fire risk assessments and rectification works are currently underway, on an asset priority basis.
- Flood risk: Development is underway of geospatial systems to conduct flood and/or storm surge assessment. Field data collection/survey has been completed.
- Earthquake: Third party Substation Condition Assessments conducted in 2005-6, together with other criteria, identified assets not meeting the current ElectraNet seismic design standards. A rectification plan has been programmed, to align with other asset refurbishment works undertaken on a priority basis.

ElectraNet also notes that the AER has also previously recognised in relation to natural disaster events that “a prudent service provider through its actions could not have reasonably prevented the event from occurring or substantially mitigated the cost impact of the event”<sup>15</sup>.

- ElectraNet has commercial insurance which would cover some of the costs of specific natural disasters (such as earthquakes), up to the policy limit. Additional commercial insurance cover above the current limit is not widely available. A report commissioned by Grid Australia highlighted that commercial insurance for damage to transmission and distribution lines is generally not available for cover above US\$20m, even though the potential risk exposure to TNSPs can easily exceed that level.<sup>16</sup>
- The potential severity of the cost impact of a natural disaster event means that it is a risk which ElectraNet believes cannot be credibly self-insured. Moreover, the lack of a commercial insurance market to address this risk means that data on insurance premiums is not available, making a reliable calculation of a self-insurance premium difficult. ElectraNet notes that the AER concluded in its determinations for both the Victorian DNSPs and for Aurora that a natural disaster event satisfied the criteria that the pass through event cannot be self-insured because a self-insurance premium cannot be calculated or the potential loss to the relevant NSP is catastrophic.<sup>17</sup>

### 3.3 Implications for insurance and self-insurance allowances

ElectraNet considers that its current level of commercial insurance cover in relation to natural disasters is appropriate, and represents a prudent approach to mitigating the cost impact on ElectraNet of such an event. ElectraNet does not therefore propose to make any amendments to the forecast insurance premiums included in its Revenue Proposal.

<sup>15</sup> See for example: AER, *Victorian electricity distribution network service providers Distribution determination 2011–2015, Final Decision*, October 2010, p. 745 & AER, *Distribution Determination Aurora Energy Pty Ltd 2012–13 to 2016–17*, November 2011, Draft Decision, p. 285.

<sup>16</sup> Marsh, *Quantification of the cost of specific low probability, high impact events and associated availability of commercial insurance*, 16 September, p. 2.

<sup>17</sup> AER, *Victorian electricity distribution network service providers Distribution determination 2011–2015, Final Decision*, October 2010, p. 745 & AER, *Distribution Determination Aurora Energy Pty Ltd 2012–13 to 2016–17*, November 2011, Draft Decision, p. 285.

ElectraNet's Revenue Proposal did not include any amount within the proposed self-insurance allowance to reflect self-insurance for natural disaster events.<sup>18</sup> An amount was included to reflect self-insurance for line failures arising from local storm damage (high winds). However such localised events would be unlikely to be considered a 'natural disaster'. ElectraNet considers that self-insuring for localised storm damage represents a prudent approach. As a result, no change has been made to the self-insurance allowance to reflect inclusion of a natural disaster event as a pass through event.

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<sup>18</sup> An amount was included in relation to self-insurance for third party claims for bush fire liability above insurance limits. This is discussed in section 4.3, in connection with the proposed insurance cap event.

## 4. Insurance cap event

### 4.1 Proposed definition

ElectraNet proposes that an ‘insurance cap event’ be included in the AER’s determination for the 2013/14-2017/18 period as a pass through event.

ElectraNet’s proposed definition of this event is:

‘Either:

- (a) ElectraNet incurs a liability or liabilities; or
- (b) an event occurs,

where:

- (c) the incurring of that liability or those liabilities or the occurrence of that event would, but for the existence of a relevant policy limit, entitle the provider (or another person on its behalf) to receive a payment, or a greater payment, under the insurance policy to which that limit applies; and
- (d) the costs that are incurred or are likely to be incurred by the provider in respect of that liability or those liabilities or in respect of that event, and that would be covered by the insurance policy but for the relevant policy limit, are such as to *materially* increase the costs to ElectraNet of providing *prescribed transmission services*.

For the purpose of this event, the relevant policy limit for an insurance policy means any limit on the maximum amount that can be claimed under that insurance policy, including a limit set on the maximum amount of a single claim or on the maximum amount of a number of claims over a certain period of time.’

The inclusion of this pass through event provides an appropriate means of addressing the risk associated with costs arising from third party liability claims, in excess of insured limits. It also addresses the more general issue of the management of risks in excess of commercial insurance limits.

ElectraNet notes that the AER has approved similar insurance cap events for the Victorian DNSPs<sup>19</sup> and also for Aurora in Tasmania.<sup>20</sup> ElectraNet notes that its proposed definition of an insurance cap event differs from these earlier approved events (which in turn differed significantly from each other), in order to clarify what ElectraNet sees as important characteristics of this pass through event.

Under ElectraNet’s proposed definition, an insurance cap event is deemed to have occurred either: (a) when the underlying event leading to the insurance claim occurs; or (b) when ElectraNet incurs a liability or liabilities in relation to that underlying event. As noted earlier, liability claims typically occur after the 90 business day period within which a pass through application needs to be lodged under the Rules. ElectraNet considers that the definition should explicitly cover both of these potential triggers.

<sup>19</sup> AER, *Victorian electricity distribution network service providers Distribution determination 2011–2015, Final Decision*, October 2010, p. 797.

<sup>20</sup> The AER approved a ‘liability above insurance cap event’. AER, *Aurora 2012-17 Draft Distribution Determination*, p. 39.

The proposed definition does not require the event to be beyond the control of ElectraNet. TNSPs typically take out insurance to cover instances of negligence. Indeed, the AER has previously accepted that there should be no exclusion from the coverage of an insurance cap event for events arising out of an NSP's 'negligence, fault or lack of care'.<sup>21</sup> However, the proposed definition ties the insurance cap event to whether or not the costs that have been incurred would have been covered by an insurance policy. ElectraNet notes that in the event that it did not meet the criteria for being able to call on its insurance cover (for example, in a case where there has been 'wilful negligence' and that is not covered by the insurance policy), then it would also not be able to apply for a cost pass through under this insurance cap event.

The proposed definition of an 'insurance cap event' also requires that the occurrence of the event or liability must *materially* increase the costs incurred or expected to be incurred by ElectraNet. For TNSPs, 'material' is defined under the Rules as exceeding 1% of the TNSP's Maximum Allowed Revenue for that regulatory year. As a consequence, the proposed pass through event will only apply when the costs faced by ElectraNet above the limits of its insurance policies are themselves material, rather than for any increase in costs above the insured limit.

## 4.2 Nominated pass through considerations

In relation to the nominated cost pass-through considerations, ElectraNet notes the following:

- The event is not covered by a category of pass through event specified in clause 6A.7.3(a1) (1) to (4).
- The nature and type of event can be clearly identified at the time of the AER's determination, as evidenced by the proposed definition. The AER has previously concluded that an insurance cap event meets this consideration, in its determinations for the Victorian DNSPs and Aurora.<sup>22</sup>
- The extent to which ElectraNet can reasonably prevent a claim occurring which exceeds its insurance cap, or can mitigate the cost impact of such an event, is limited. The AER has previously concluded that an insurance cap event satisfies this consideration, in its determinations for the Victorian DNSPs and Aurora.
- ElectraNet does take out insurance to manage the risk of third party liability claims. However the coverage of such insurance is typically capped, with levels of cover above the cap typically requiring very high premiums. The earlier study commissioned by Grid Australia found that bushfire liability insurance is only available at higher limits for premiums in the order of US\$20,000-\$50,000 per million dollars insured.<sup>23</sup> That study also highlighted that cover for general liability insurance (as distinct from bushfire liability cover) is generally only available up to a certain limit, beyond which it is unavailable or uneconomic.<sup>24</sup>

<sup>21</sup> AER, *Victorian electricity distribution network service providers Distribution determination 2011–2015, Final Decision*, October 2010, p. 792-793.

<sup>22</sup> AER, *Victorian electricity distribution network service providers Distribution determination 2011–2015, Final Decision*, October 2010, p. 797; AER, *Aurora 2012-17 Draft Distribution Determination*, p. 39.

<sup>23</sup> Marsh, *Quantification of the cost of specific low probability, high impact events and associated availability of commercial insurance*, 16 September, p. 8.

<sup>24</sup> Marsh, *Quantification of the cost of specific low probability, high impact events and associated availability of commercial insurance*, 16 September, p. 8.

- Including an insurance cap event as a pass through event represents a more appropriate means of managing the risk of such events, given the data limitations associated with trying to calculate a reliable self-insurance premium. The self-insurance allowance included in ElectraNet's Revenue Proposal included an amount for above insurance cap risk for fire liability. However, in quantifying this amount, Aon noted that limited data availability meant that 'the views of the insurance market' had to be used as an input.<sup>25</sup> Lack of objective data on which to base a self-insurance quantification necessarily leads to a greater level of uncertainty around such quantification. ElectraNet further notes that Aon did not quantify other categories of above insurance cap risk, due to a lack of data on which to base robust quantification.<sup>26</sup> In terms of the materiality of this risk, ElectraNet notes that the cost of third party liability claims associated with bushfires can be substantial, especially where there are multiple fires, such that it could have a significant impact on ElectraNet's ability to provide network services.

### 4.3 Implications for insurance and self-insurance allowances

ElectraNet does not consider that any change to the forecast insurance premiums included in its Revenue Proposal would be required, where the AER approves the inclusion of an insurance cap event. The insurance cap event does not provide an incentive for ElectraNet to lower the extent of its insurance coverage. Where the AER has approved the inclusion of an amount in ElectraNet's operating expenditure allowance to reflect the premiums for commercial insurance cover, ElectraNet would expect that the AER would take this into account in assessing any cost pass through application. If ElectraNet were to subsequently decide not to maintain a level of insurance cover that is commensurate with those premiums, the AER would be able to consider whether ElectraNet had, in reducing its insurance cover, 'failed to take any action that could reasonably be taken to reduce the magnitude of the eligible pass through amount' or whether ElectraNet had 'taken or omitted to take any action where such action or omission has increased the magnitude or the amount in respect of the positive change event' (clause 6A.7.3(j)(3)).

As noted above, the self-insurance allowance included in ElectraNet's Revenue Proposal did include an amount to cover the risk of above insurance limit risk for bush fire liability. ElectraNet proposes to reduce its self-insurance allowance by this amount, where the AER accepts the proposed insurance cap event, as set out in Section 5. Details of the amendments made to the self-insurance allowance compared with that presented in the Revenue Proposal are set out in Appendix A. ElectraNet is also submitting a revised version of the earlier self-insurance quantification report prepared by Aon, which has been prepared on the basis that above insurance limit risk will be addressed by the proposed insurance cap event, rather than being self-insured.

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<sup>25</sup> Aon, Self Insurance Risk Quantification, May 2012, p, 26.

<sup>26</sup> Further details are provided in Appendix A.



## 5. Revised self-insurance allowance

As discussed above, the self-insurance allowance included in ElectraNet's Revenue Proposal included compensation for bearing the risk of above insurance limit risk for bush fire liability. Acceptance by the AER of the proposed insurance cap event as a pass through event for the 2013/14-2017/18 regulatory control period would mean that ElectraNet would no longer be self-insuring in relation to such liability risks. As a consequence, ElectraNet's required self-insurance allowance for the 2013/14-2017/18 would be lower than that incorporated in the Revenue Proposal.

Table 5.1 sets out ElectraNet's revised self-insurance allowance for the forthcoming regulatory control period, based on acceptance by the AER of the three nominated pass through events included in this application. The basis for the change in self-insurance allowance is set out in Appendix A. The revised amount also reflects that in the revised Aon report, submitted with this proposal.

**Table 5.1: Self-insurance allowance (\$m 2012-13)**

	<b>2013-14</b>	<b>2014-15</b>	<b>2015-16</b>	<b>2016-17</b>	<b>2017-18</b>	<b>Total</b>
Revenue Proposal	1.4	1.5	1.5	1.5	1.6	7.5
Amended allowance	1.3	1.3	1.4	1.4	1.4	6.8

## Appendix A Changes to self-insurance allowance

This Appendix details the proposed changes to ElectraNet's self-insurance allowance for the 2013-2018 regulatory control period.

The self-insurance allowance included in ElectraNet's Regulatory Proposal was based on quantification of ElectraNet's self-insurance risk undertaken by Aon under the Rules in force at that time, and submitted to the AER as Appendix V to the Revenue Proposal.

Aon's revised quantification of ElectraNet's self-insurance allowance under the current Rules is also attached (as Appendix B). This revised quantification is based on the assumption that the three pass through events proposed by ElectraNet are accepted by the AER.

### A1 Self-insurance for terrorism risks

There was no allowance made in the earlier quantification undertaken by Aon for self-insurance in relation to terrorism events, given that the Rules in place at the time of submission of the Regulatory Proposal included a terrorism event as a defined pass through event.

### A2 Self-insurance for above insurance cap risks

The earlier Aon self-insurance allowance quantification included an estimated amount in relation to above insurance limit risk for fire liability only.

Fire liability risk is ElectraNet's legal liability to pay compensation for economic loss, bodily injury and/or property damage to third parties caused by a fire arising from ElectraNet's business operations.

Losses relating to Fire Liability are insured by ElectraNet's Combined Fire and General Liability policy. Aon concluded in its May report that ElectraNet has a significant self-insured exposure above its limit of liability in the absence of a pass through event, despite the inherent low likelihood of this occurring.<sup>27</sup> Aon quantified this risk as set out in Table A.1.

**Table A.1: Self-insurance allowance: Fire liability (\$m nominal)**

	2013-14	2014-15	2015-16	2016-17	2017-18	Total
Fire liability	0.131	0.128	0.133	0.150	0.149	0.691

Aon also identified in its May report that ElectraNet did face potential above insurance cap liabilities for other types of event. However, it did not quantify these liabilities in its report, on the basis that the likelihood of such losses was not material and/or the lack of data availability on which to base quantification. Specifically:

- Substation machinery breakdown: Aon explicitly noted in its May report that no above limit losses were included in the self-insurance cost for this risk category, as in Aon's view the limit of liability should be sufficient on all occasions.<sup>28</sup>
- General property damage (insured assets): Aon noted that ElectraNet is exposed to losses under this category that exceed the limit of its insurance. However Aon did not quantify

<sup>27</sup> Aon, Self Insurance Risk Quantification, May 2012, p, 24.

<sup>28</sup> Op cit, p.16.

this above limit risk, on the basis that there was little or no supporting data to utilize and the low materiality of this risk.<sup>29</sup>

- General liability: Aon's conclusion was that the extent of a General Liability claim exceeding the current limit of liability would be remote. As a result, no above limit losses were included in the self-insurance cost for this risk category.<sup>30</sup>
- Failure to supply: Aon noted that any risk exceeding the current limit of liability would be extremely rare.<sup>31</sup>
- Professional Indemnity, Directors' and Officer's liability: Aon noted that ElectraNet has a conceivable and potentially substantial risk exceeding the limit of liability for these risk categories, despite a low likelihood of occurrence.<sup>32</sup> Given the low likelihood of occurrence and the lack of supporting data available to quantify these exposures, none of these above limit losses were included in the self-insurance quantification for these risk categories.

### A3 Natural disasters

The proposed self-insurance allowance in ElectraNet's Regulatory Proposal did not include any quantification in relation to events triggered by natural disasters.

The self-insurance amount calculated by Aon in its May report included an amount for line failures risk. Aon based its quantification of line failures on 17 loss events between 1962 and 2011, which would not have been categorised as 'business as usual events'. Further investigation has shown that these events are all due to localised storm events (i.e., high winds) - and one vandalism event - rather than being wide-scale 'natural disaster' type events (i.e., storm, flood, bush fire). As a consequence, the quantification of line failure risk relates to self-insurance in relation to these localised storm events, and would not be covered by the 'natural disaster' pass through event.

The other self-insurance categories quantified by Aon in its May report were not related to natural disasters:

- General property damage (uninsured assets): losses are typically caused by vandalism or accidental damage from third parties.
- Substation machinery breakdown: losses arise as the result of equipment failure (or machinery breakdown).
- General property damage (insured assets): Aon noted that losses can be caused by natural disasters (e.g., storms - including lightning - or earthquake), as well as vandalism and theft (specifically copper theft). However, Aon noted that historically the level of losses has not exceeded \$20,000 and so this risk was not included in the self-insurance quantification.<sup>33</sup>

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<sup>29</sup> Ibid.

<sup>30</sup> Op cit, p.22.

<sup>31</sup> Op cit, p. 31.

<sup>32</sup> Ibid.

<sup>33</sup> Op cit, p.20.

## **A4 Proposed adjustment to self-insurance allowances**

The proposed adjustment to the self-insurance allowance for the 2013/14-2017/18 regulatory control period to reflect the AER's acceptance of ElectraNet's three proposed pass through events is set out in Table A.2. ElectraNet notes that this amount is consistent with that included in Aon's revised report.

**Table A.2: Self-Insurance loss forecast (nominal \$)**

	<b>2013-14</b>	<b>2014-15</b>	<b>2015-16</b>	<b>2016-17</b>	<b>2017-18</b>	<b>Total</b>
Total Aon May 2012	1.479	1.507	1.546	1.595	1.630	7.755
<i>minus</i>						
Fire liability	-0.131	-0.128	-0.133	-0.150	-0.149	-0.691
Amended allowance (nominal \$)	1.348	1.379	1.413	1.445	1.480	7.064
Amended allowance (\$ 2012-13)	1.300	1.330	1.363	1.394	1.427	6.814

## **Appendix B Aon Self Insurance Risk Quantification, Revised Report**