



Ref: 20201026MC:CB

27 October 2020

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

Dear Mr Roberts

Essential Energy submission to consultation paper on Insurance pass through coverage events

Essential Energy welcomes the opportunity to provide comments on the Australian Energy Regulator's (AER's) consultation paper on its guidance note on key matters they are likely to have regard to when assessing an insurance coverage event application.

The global insurance market has changed significantly in recent years resulting in reduced capacity and increased costs for certain products procured by network businesses, especially in relation to bushfire liability. As a result of these pressures, Essential Energy faces an increase in its liability insurance costs from █████ in 2015-2016 to approximately █████ in 2020-21. Stakeholder consultation on this subject is increasingly important given the ongoing hardening of the insurance market and potential for insurance cost pass through (CPT) events in the future.

In considering the issues raised in the consultation paper Essential Energy has focussed its response on access to affordable general and bushfire liability insurance, as we consider this presents by far the most pressing insurance challenge for Network Service Providers (NSPs). Whilst premiums for other insurance products (e.g. buildings/contents; director's and officers') purchased by Essential Energy are also increasing, it is global underwriters' concern about bushfire litigation risks faced by Australian NSPs that appears to be driving the most severe premium increases and capacity shortages.

We note that Essential Energy does not insure (and never has insured) its 'poles and wires' against the risk of damage to those assets, although insurance is held against damage to larger sites, buildings and equipment at those sites. We understand this position is consistent with that adopted by other NSPs, reflecting the general unavailability of such coverage in the insurance market and other complexities around attempting to insure the risk.

Essential Energy suggests that when reviewing the prudence and efficiency of the insurance procurement undertaken by NSPs, the AER considers the networks' 'total cost of risk' which includes a range of factors such as policy deductibles (excesses) as well as the level of insurance cover selected and each networks' risk profile (especially bushfire risk). Any assessment of insurance prudence and efficiency would likely be required to be undertaken by an independent insurance expert with knowledge of Australian bushfire risk and estimated maximum losses.

We are supportive of the potential collation of insurance information from NSPs to ensure relevant information is available to NSPs to promote an understanding of market-wide trends and the relative costs of alternative insurance arrangements and programs.

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ATTACHMENT 1 - Essential Energy submission to consultation paper on Insurance pass through coverage events
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Our responses to the questions posed in the consultation paper are provided in **Attachment 1**. We have chosen to focus our responses on particular questions rather than cover all questions posed. Confidentiality templates are also completed and provided in **Attachments 2 and 3**.

If you have any questions in relation to this submission, please contact [REDACTED]

Yours sincerely

A handwritten signature in black ink that reads "Chantelle Bramley". The signature is written in a cursive, flowing style.

Chantelle Bramley
General Manager Strategy, Regulation and Corporate Affairs

Question 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 taken into account. This could include any aspects which Network Service Providers consider are specific to their business circumstances and operating environment.*

We believe that the current assessment elements are sufficiently broad.

Question 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 taken into account.*

We recommend that the AER obtain independent expert assessments of insurance risks and coverage for the NSP that has submitted a CPT application. With the level of change in the insurance market, up to date and relevant advice is important. Reflecting this, Essential Energy has recently seen some insurance premiums more than double, meaning that assessing the efficient allocation of risks, and least cost options needs to be current.

Question 4: *Do stakeholders see benefits in us having an annual information provision process for Network Service Providers 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, Network Service Providers 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 Network Service Providers are likely to use an annual opt in process.*

Although Essential Energy is supportive of the collation of insurance information from NSPs, any information garnished from NSPs would need to be sufficiently summarised and anonymised to ensure it does not affect the competitive nature of future insurance tendering processes. The collection and release of information needs to carefully balance, enabling a greater understanding of changes in the market and potentially allow a greater level of competition to be fostered amongst insurance providers, against the adverse impact of competitive processes leading to higher insurance premiums.

We are in favour of greater transparency of insurance information across the NSPs, however there may be some confidentiality issues raised. Perhaps the AER could provide reporting (not benchmarking) of the range of insurances/premiums in use on an anonymous basis.

Question 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, Network Service Providers and other stakeholders. This information could be captured as part of the annual Regulatory Information Notice or a separate annual opt in process.*

We agree that this information could be collected as part of the annual RIN process, however, we have some concerns with its utilisation for benchmarking. This would be difficult to undertake due to different assets, risks, insurance history, timing and operating conditions across NSPs. There could also be confidentiality issues.

Question 6: *What processes are in place (or planned) by Network Service Providers 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 Network Service Providers 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 Network Service Providers to be efficient and cost effective are affected in their efforts to minimise their exposure above the insurance cover limit or gaps in their insurance policies? How can we incentivise a Network Service Provider to be prudent and efficient under these circumstances?*

Essential Energy currently purchases general and bushfire liability insurance with an insured limit of ██████ per occurrence and subject to a deductible/excess of ██████. We understand that both the insured limit and policy deductible are high relative to other Australian NSPs. In 2016-17 Essential Energy's ██████ liability insured limit was assessed by independent catastrophe modellers at Aon Benfield as being likely to be exceeded only once every 893 years.

In the interest of cost efficiency, this insurance has been purchased jointly with Endeavour Energy (and predecessors) for more than 30 years. We would look to submit a cost pass through for any amount that exceeded the insured limit, or in circumstances where there were gaps in cover (subject to cost pass through eligibility). Any limitations or reductions in coverage would be reflected in lower premiums (lower network charges), so it is reasonable that if a low probability event occurred that costs are recovered after the fact from customers in network charges.

A consideration with CPT application is the finalising of the value of the claim event – it is not unusual for large liability claims to take many years to settle, meaning the application timing and recovery of any approved amount could potentially be problematic. The intrinsically difficult nature of this process means that it is an option that NSPs would rather avoid if possible. Therefore, the existence of an insurance coverage pass through event does not provide an incentive for NSPs to be less conscientious in the management of their insurance coverage. Rather, it is viewed as a last resort measure to be utilised in only exceptional circumstances.

In terms of incentives to minimise exposure, it is inherent on NSPs to handle liability claims sensibly, resolve them quickly and prudently, and not defend claims if there is no reasonable prospect of success.

Title, page and paragraph number of document containing the confidential information.	Description of the confidential information.	Topic the confidential information relates to (e.g. capex, opex, the rate of return etc.)	Identify the recognised confidentiality category that the confidential information falls within.	Provide a brief explanation of why the confidential information falls into the selected category. If information falls within ‘other’ please provide further details on why the information should be treated as confidential.	Specify reasons supporting how and why detriment would be caused from disclosing the confidential information.	Provide any reasons supporting why the identified detriment is not outweighed by the public benefit (especially public benefits such as the effect on the long term interests of consumers).
Essential Energy submission to consultation paper on Insurance pass through coverage events Page 1 - paragraph 2 Page 4 - paragraph 2	Insurance costs, limits and excess	Opex	Market sensitive cost inputs	The publishing of the detail of Essential Energy's insurances could be of interest to potential insurers, and commentators	The publishing of the detail of Essential Energy's insurances in the submission, may affect the competitive nature of future insurance acquisitions, may result in higher premiums being offered, and indicate that the business has an unlimited willingness or capacity to pay.	

Submission Title	Number of pages of submission that include information subject to a claim of confidentiality	Number of pages of submission that do not include information subject to a claim of confidentiality	Total number of pages of submission	Percentage of pages of submission that include information subject to a claim of confidentiality	Percentage of pages of submission that do not include information subject to a claim of confidentiality
Essential Energy submission to consultation paper on Insurance pass through coverage events	2	2	4	50%	50%