Addendum to Attachment 6 [Operating Expenditure] of the Revised Proposal

This document is an addendum to Attachment 6 [Operating Expenditure] of our revised proposal for the 2020-25 regulatory control period (**2020-25 RCP**). Our revised proposal for the 2020-25 RCP (**Revised Proposal**) was submitted on 10 December 2019.

This Addendum proposes a further operating expenditure (**opex**) step change in relation to our annual bushfire liability insurance premiums[1] during the 2020-25 RCP (**Bushfire Step Change**) and provides detailed information and evidence in support of the granting of that step change.

1. Revised Proposal

In our Revised Proposal, we echoed the concerns we raised in our original proposal for the 2020-25 RCP (**Original Proposal**) that there was a real possibility that we would be unable in the future to secure:

- the same level of insurance cover with respect to liability for causing bushfires as we had been able to secure during previous regulatory years (and, in particular, during the 2018-19 base year); and
- insurance cover for all of our bushfire liability risks on reasonable commercial and economic terms.[2]

In the end, we were able to obtain bushfire liability insurance cover on reasonable commercial and economic terms for the 2019-20 insurance year[3] (albeit that the final premium was materially higher than the previous insurance year's premium) with:

- the same general scope of cover as applied under our bushfire liability insurance program for the 2018-19 base year (e.g. the same level of deductibles, no gaps in the layers of insurance cover, no additional material exclusions or limits but with a gap in our overall reinstatement rights); and
- a maximum level of cover which was not materially lower than the base year's maximum level of cover.[4]

Even though we were able to obtain bushfire liability insurance cover on reasonable commercial and economic terms for the 2019-20 insurance year, our insurance brokers have warned us, and the insurance markets in general have indicated, that we are likely to face significant challenges in securing the same level of insurance cover on reasonable commercial and economic terms during the 2020-25 RCP for two main reasons.

First, the available capacity for bushfire risk insurance in the international insurance market is expected to continue to tighten. This tightening (i.e. reduction in available capacity) will almost certainly worsen as a result of the recent catastrophic bushfire events in Australia. As the AER

[1] As noted in section 4 of this Addendum, bushfire liability risk is covered under our Combined Liability insurance. Whilst these insurance policies also cover other third party legal liability risks, nearly all of the premium relates to bushfire liability risk and the expected increase can be attributed almost solely to bushfire liability risk.

[2] SA Power Networks, *2020-25 Revised Regulatory Proposal* – Attachment 13 – Pass through events (**Attachment 13**), page 10.

[3] Our insurance year is the 12 month period starting at 4PM on each 30 September.

[4] SA Power Networks, Attachment 13, page 6.

would appreciate, a reduction in the number of insurers offering bushfire liability insurance cover is likely to lead to:

- an increase in the premiums for the available bushfire liability insurance cover; and
- a narrowing of the scope of the available bushfire liability insurance cover (for example, gaps in the level of cover, increased deductibles, lower maximum limits for some layers of insurance cover, broader exclusions, etc.).

Second, the increasing severity and frequency of extreme weather events in the last 10 years has resulted in larger and more frequent levels of insurance claims and this has in turn led to a material increase in bushfire liability insurance premiums. (For example, SA Power Networks' annual bushfire liability insurance premiums have increased by more than 66% since the 2006/07 insurance year)[5].

There is no question that the recent catastrophic bushfire events in Australia will lead to an exponential increase in the level of our bushfire liability insurance premiums and this increase is expected to continue and perhaps worsen during the 2020-25 RCP[6].

2. Developments since the submission of our Revised Proposal

In our Revised Proposal we explained why:

- the market for bushfire liability insurance was expected to continue to tighten;
- the severity and frequency of extreme weather events was expected to continue to increase; and
- our ability to obtain bushfire liability insurance during the 2020-25 RCP (and future periods) with substantially the same level of cover as we have historically been able to obtain was likely to be severely impacted.

For these reasons, we proposed some clarifications to the insurance cap pass through event in our Revised Proposal. These clarifications were designed to address the possibility that we would be unable to secure 'full' bushfire liability insurance cover during the 2020-25 RCP.[7] Once again, the recent catastrophic bushfire events will increase this risk and the possibility that there will be 'gaps' in our bushfire liability insurance cover during the 2020-25 RCP and beyond.

Since the submission of our Revised Proposal in December 2019, further information has come to light which significantly exacerbates our concerns in relation to:

- the extent of the cover that will be provided by future bushfire liability insurance; and
- in particular, the likely future cost of and cost trajectory for bushfire liability insurance premiums during the 2020-25 RCP.

[5] See Appendix 3 and section 7 of Annexure A for details concerning the increase in our bushfire risk insurance premiums over this period.

[6] See the commentary in the Marsh Report.

[7] Ibid page 11.

This new information has led us to seek this Bushfire Step Change (as a distinct and separate issue to the proposed changes to the insurance cap pass through event).

In the last 2 weeks of January, we were advised by our insurance broker, Marsh, that:

- there would almost certainly be a significant and material increase in the premiums required to be paid for bushfire liability insurance from the commencement of the next insurance year (i.e. the 12 month period commencing at 4 PM on 30 September 2020); and
- any such increase would continue and most likely worsen during the 2020-25 RCP.

This news is not surprising given the seriously devastating fires that have been experienced in large parts of Australia since we lodged our Revised Proposal in early December 2019. In South Australia, large areas in the Adelaide Hills, on Kangaroo Island and around Yorketown at the bottom end of Yorke Peninsula have been devasted by recent bushfires. These bushfires have caused significant and widespread property damage and, tragically, loss of life. As the AER would be aware, those fires have led, and will continue to lead, to a large number of insurance claims and, in turn, to material increases in bushfire liability insurance premiums during the 2020-25 RCP.

Following the receipt of this information from Marsh, we engaged Marsh to prepare a detailed paper addressing the likely increase in premiums for bushfire liability insurance during the 2020-25 RCP (**Marsh Report**).[8] The Marsh Report addresses the current and likely bushfire liability insurance market conditions and explains how those market conditions together with the recent increase in catastrophic bushfires and other natural disaster events around the world will lead to a sustained and material increase in the premiums for bushfire liability insurance. The Marsh Report, and the other information referenced in this Addendum, the Annexure and the associated appendices demonstrates that the level of increase in premiums will be significant, material and ongoing throughout the 2020-25 RCP.

We have used the information in the Marsh Report to calculate the amount of the proposed Bushfire Step Change and the resulting increase to our annual forecast opex for each regulatory year of the 2020-25 RCP as a consequence of this material increase in bushfire liability insurance premiums.

3. Addition to our Revised Proposal

Given the matters outlined above and the findings of the Marsh Report, we are now seeking a further step change in relation to our forecast opex for the 2020-25 RCP to take into account the material increase in bushfire liability insurance premiums (as compared to the level that applied during our 2018/19 base year) that we have been advised will occur during the 2020-25 RCP.

The regulatory framework for step changes is set out in the AER's Expenditure Forecast Assessment Guideline for Electricity Distribution 2013 (**EFAG**) and associated Explanatory Statement (**Explanatory Statement**).

The EFAG and Explanatory Statement set out the process and techniques that the AER employs in setting efficient expenditure allowances for network businesses, which includes the 'base-step-trend' approach.

The EFAG makes it clear that:

[8] The Marsh Report has been provided in confidential Appendix 1 to this Addendum.

- step changes may be added (or subtracted) for any costs not captured in the base year opex or the rate of change, to meet the opex criteria in the National Electricity Rules (**NER**)[9]; and

- the AER will only approve step changes in costs if they demonstrably do not reflect the historic average change in costs associated with regulatory obligations[10].

Consistently with the EFAG, the Explanatory Statement explains that the AER will adjust actual opex from the base year to account for 'changes in circumstances that will drive changes in opex in the forecast regulatory control period' (i.e. step changes), which include, amongst other things, '…costs due to changes in regulatory obligations and the external operating environment beyond the NSP's control'.[11]

Turning to these matters:

(a) ***Opex criteria and regulatory obligations***

The opex criteria are set out in clause 6.5.6(c) of the NER, and require forecast opex to reasonably reflect the efficient and prudent costs of achieving the opex objectives.

The opex objectives are set out in clause 6.5.6(a) of the NER, and include compliance with regulatory obligations or requirements associated with the provision of standard control services.

As explained in our Revised Proposal[12], SA Power Networks has a regulatory obligation, under condition 19 of our Distribution Licence issued under the *Electricity Act 1996* (SA) (**Electricity Act**), to maintain adequate and appropriate bushfire liability insurance.

In addition, we have an obligation under clause 9.1 of the lease of our electricity distribution network from the Distribution Lessor Corporation (the South Australian Government corporation who owns the assets comprised within our electricity distribution network) to maintain at least $600 million of bushfire liability insurance coverage (plus one reinstatement).

The regulatory arrangements governing network businesses make it clear that we are entitled to recover the efficient and prudent costs of meeting our regulatory obligation to maintain adequate and appropriate bushfire liability insurance. Satisfying this regulatory obligation is required in order for us to deliver standard control services for the long term interests of consumers. It is therefore critical that this proposed Bushfire Step Change be approved by the AER.

(b) ***Beyond SA Power Networks' control***

As in past insurance years, SA Power Networks will, of course, seek to negotiate the lowest possible premiums for our bushfire liability insurance for each insurance year that occurs during the 2020-25 RCP.

However, as explained in the Marsh Report, the magnitude of bushfire liability insurance premiums is ultimately a matter that is beyond our control. The premiums are set by the

[9] EFAG, page 24.

[10] Ibid.

[11] Explanatory Statement, page 11.

[12] SA Power Networks, Attachment 13, page 12.

insurance market and are controlled in part by competition between insurance providers. As noted in our Revised Proposal, the number of insurance providers who are prepared to offer bushfire liability insurance is decreasing and the premiums offered by the remaining insurers will reflect that decrease as well as the recent devastating bushfire events in Australia.[13]

The challenges presented by that market are significant, and we refer the AER to Attachment 13 of our Revised Proposal and the Marsh Report where those challenges are discussed in some detail.

(c) ***Not captured in the rate of change / not reflected in historic average change in costs***

As mentioned above, the likely minimum projected increase in the cost of bushfire liability insurance premiums for the future insurance years in the 2020-25 RCP (i.e. the best case / lowest cost scenario), is set out in the Marsh Report.

It is evident from the Marsh Report that bushfire liability insurance premiums will increase and that increase will be substantial, material and will continue and potentially worsen during the 2020-25 RCP. It follows that the resulting increase in bushfire liability insurance premiums will:

- not be adequately addressed by the rate of change that forms part of the AER's base-step-trend approach; and
- materially exceed the historic average change in those insurance premiums (we have provided details concerning the change in our combined liability insurance premiums since the 2006/07 insurance year in Appendix 3).

The AER determined in its draft decision on our Original Proposal for the 2020-25 RCP that our base year (2018-19) opex was efficient.[14]

Accordingly, given the expected material increase in bushfire liability insurance premiums over and above the quantum of bushfire liability insurance premiums that was reflected in our base year, SA Power Networks proposes this Bushfire Step Change. The magnitude of that step change is addressed below.

4. Magnitude of the Bushfire Step Change

The Marsh Report:

- has determined a best case and worst case scenario for the likely increase in SA Power Networks combined liability insurance premiums over the 2020-25 RCP;
- sets out a methodology for determining the likely (but conservative) glide path for the combined liability insurance premiums for each regulatory year of the 2020-25 RCP based on the best case and worst case combined liability insurance premiums scenario for each regulatory year; and

[13] SA Power Networks, Attachment 13, page 11.

[14] AER, Draft Decision for SA Power Networks Distribution Determination 2020-25, Attachment 6 – Operating expenditure, page 22.

- sets out a detailed explanation concerning the factors that have led (or have contributed) to this expected material increase and why those factors impact upon the cost of bushfire liability insurance.

The Marsh Report also notes at page 3 that although SA Power Networks' combined liability insurance covers more than bushfire liability, it is important to note that it is the increased risk of bushfire liability that is the principal (and arguably sole) driver of the expected increase in the combined liability insurance cover over the 2020-25 RCP.

As noted above, this Bushfire Step Change is limited to the amount of the likely increase in the total costs of SA Power Networks' combined liability insurance premiums over the 2020-25 RCP (i.e. the amount by which SA Power Networks' total combined liability insurance premiums over the 2020-25 RCP is likely to exceed the total combined liability insurance premiums over the 2020-25 RCP that would be paid if the premium cost for SA Power Networks' combined liability insurance which was included within the 2018/19 base year opex applied during the 2020-25 RCP).

Applying the findings set out in the Marsh Report, our total combined liability insurance premiums over the 2020-25 RCP (in 2018/19 real dollars) will exceed the total of the combined liability insurance premiums over the 2020-25 RCP determined using the combined liability insurance premiums for the 2018-19 base year (in 2018/19 real dollars) by an amount equal to $15,848,649.

This translates to $16,297,461 in Real June 2020 dollars and is the total amount (in Real June 2020 dollars) of the step change in forecast opex we are seeking for the 2020-25 RCP on account of the expected conservative increase in our combined liability insurance premiums over the 2020-25 RCP.

Set out below is a table which sets out the step change in forecast opex for each regulatory year of the 2020-25 RCP (in Real June 2020 dollars) required to accommodate the step change detailed in the above paragraph.

(June 2020, $ million)	2020/21	2021/22	2022/23	2023/24	2024/25	Total
Bushfire step change	2.1	3.0	3.6	3.8	3.8	**16.3**

5. SA Power Networks' process for obtaining bushfire liability insurance

As indicated above, we were ultimately able to obtain bushfire liability insurance cover (on reasonable commercial and economic terms) for the 2019-20 insurance year which provides a similar level of cover to the bushfire liability insurance cover we were able to obtain for the 2018/19 insurance year. In order to do this, we investigated all possible avenues for bushfire liability insurance cover during the first nine months of 2019, including consulting with the Essential Services Commission of South Australia (**ESCoSA**), the South Australian Government and the AER.

During that consultation process we explained:

- the procurement and governance processes we followed when investigating and analysing possible sources and levels of bushfire liability insurance cover; and
- the criteria we were proposing to use to guide our final decision concerning the form and level of our bushfire liability insurance program.

Annexure A to Attachment 13 of our Revised Proposal included a detailed explanation of the procurement and governance processes we follow when:

- investigating the current availability of bushfire liability insurance cover; and
- reaching our final decision concerning our bushfire liability insurance program.

We have repeated this explanation in the Annexure to this submission because it demonstrates the level of due diligence, governance and endeavour which underpins our combined liability insurance procurement processes and ensures that the insurance we obtain is prudent, efficient and satisfies our regulatory obligations and requirements.

SA Power Networks will adopt the same processes in the lead up to the placing of its bushfire liability insurance program for each insurance year during the 2020-25 RCP, namely:

- SA Power Networks will use the limits, scope and other terms of its bushfire liability insurance program for the 2018-19 base year as the target benchmark for its bushfire liability insurance program for each insurance year during the 2020-25 RCP.
- If it becomes clear to SA Power Networks that the 2018-19 base year target benchmark no longer reflects the level of insurance cover that an efficient and prudent network service provider (NSP) would obtain under the then current insurance market conditions, SA Power Networks will consult with the AER concerning the adjustment that should be made to its target benchmark for its bushfire liability insurance program for the relevant insurance year.
- At least 30 days prior to the date on which the bushfire liability insurance program for an insurance year is required to be placed, SA Power Networks will provide to the AER relevant details concerning insurance market conditions and the bushfire liability insurance program SA Power Networks believes it will be able to secure on reasonable commercial terms for the relevant insurance year.
- SA Power Networks will then consult with the AER concerning its proposed bushfire liability insurance program for the relevant insurance year and explain why that insurance program is consistent with the level of insurance cover that an efficient and prudent NSP in SA Power Networks current circumstances would obtain in respect of bushfire liability.

SA Power Networks believes that following this type of consultation process will be in the long-term interests of consumers of electricity with respect to price because it promotes transparency and gives the AER and other stakeholders comfort that SA Power Networks is using all reasonable endeavours to minimise the cost of its combined liability insurance whilst ensuring that it maintains a level of combined liability insurance that is prudent, efficient and satisfies its regulatory obligations and requirements.

6. Additional information

Recent bushfire activity across Australia and the world

The Marsh Report emphasises the importance of this factor on the future level of bushfire risk liability premiums.

It is clear from recent bushfire events across Australia that the effect of those events can be catastrophic. [15] Organisations, including the Bureau of Meteorology and CSIRO, have been undertaking research into the occurrence, severity and frequency of bushfires. Their research shows that, unfortunately, these events are becoming the new norm.

The Bureau of Meteorology notes the following on its website:[16]

> *"Climate change is influencing the frequency and severity of dangerous bushfire conditions in Australia and other regions of the world, including through influencing temperature, environmental moisture, weather patterns and fuel conditions. There have been significant changes observed in recent decades towards more dangerous bushfire weather conditions for various regions of Australia.*
>
> *In particular, observed changes in southern and eastern Australia include more extreme conditions during summer, as well as an earlier start to the bushfire season with dangerous weather conditions occurring significantly earlier in spring than they used to. These trends towards more dangerous bushfire conditions are at least partly attributable to human-caused climate change, including through increased temperatures…*
>
> *In Bushfire weather conditions in future years are projected to increase in severity for many regions of Australasia, including due to more extreme heat events, with the rate and magnitude of change increasing with greenhouse gas concentrations (and emissions)."*

In addition, the CSIRO states that '…the frequency and severity of fire weather has increased over recent decades…We predict many regions will see a significant increase in the highest levels of fire danger in the year ahead.'[17]

The recent level of bushfire activity within Australia and across the world, coupled with the evidence that the level of activity is continuing to increase, means that it is almost certain that there will be flow-on effects to bushfire liability insurance premiums as the international bushfire liability insurance market responds to the clear perception that:

- the risk of bushfire events in Australia (and across the world) has materially increased; and

[15] For example, a State of Emergency has been declared in the Australian Capital Territory as the bushfires continue to approach the capital city. See: https://esa.act.gov.au/state-emergency-place-act.

[16] See: http://www.bom.gov.au/weather-services/fire-weather-centre/bushfire-weather/index.shtml.

[17] See: https://www.csiro.au/en/Research/Environment/Extreme-Events/Bushfire/Bushfire-research.

- the severity and the length of fire seasons is also continuing to increase.

As discussed in the Marsh Report, there is a clear perception in the insurance market that significant increases in bushfire activity and the severity of bushfire conditions has become the new norm. This is one reason why the Marsh Report states that SA Power Networks should expect to face further increases in bushfire liability insurance premiums as the bushfire liability insurance market adjusts those premiums to account for a perceived increased risk in providing that insurance to electricity network businesses like SA Power Networks.

It is also important to note that the bushfire liability insurance market takes into account all bushfire events, and not just those caused by electricity networks. Payouts by bushfire liability insurers to businesses that have made claims on their bushfire liability insurances in recent years have exceeded the premiums paid to the insurers by those businesses. This phenomenon and the likely reaction of insurers is explained in more detail in the Marsh Report.

It is clearly not economically viable for an insurer to continue to pay out amounts in response to claims on insurance policies that are more than the amounts paid as premiums for those policies. The natural and obvious response is to either withdraw from that part of the insurance market or increase premiums to a level which affords the insurer a margin on top of its likely costs and allows for the recovery of past losses over time. Either option will lead to material increases in the premiums payable by insured businesses, including SA Power Networks.

Our bushfire mitigation strategy

The Marsh Report explains how SA Power Networks' bushfire mitigation strategies impact upon the placement of its combined liability insurance program and how those strategies influence the terms of the combined liability insurances that are offered to SA Power Networks.

There is a significant risk of liability from fire starts in South Australia. As such, SA Power Networks places considerable organisational focus on bushfire liability risk mitigation. That risk mitigation includes the following key bushfire liability management processes and procedures:

- inspection, patrol and maintenance programs to identify and rectify potential fire start defects;
- vegetation management around powerlines;
- monitoring and analysing fire start data to identify fire start defects;
- assignment of specific roles and accountabilities for managing:
    - the preparations for the bushfire danger season;
    - the coordination of field and control room operations on high bushfire danger days;
- the establishment and regular review of procedures to reduce fire start risk;
- the review of lessons for utilities from relevant interstate and international bushfire investigations; and
- the establishment and regular review of procedures to manage the risk of fire starts on high fire danger days.

In addition, we have established a dedicated Bushfire Risk Management Committee that is accountable to the CEO for the review and improvement of our practices and procedures in relation to bushfire risk management.

That Committee is responsible for:

- overseeing the development and approval of strategies for enhancing bushfire risk management practices;

- ensuring a coordinated approach to bushfire risk management throughout the organisation;

- ensuring effective systems exist for identifying and rectifying unacceptable operational fire start performance; and

- ensuring effective systems exist for continuous improvement in bushfire risk management practices.

SA Power Networks has also been given certain statutory powers which are designed to reduce the risk of bushfires caused through the operation of our assets. Provided those powers are properly exercised, certain immunities have been granted to SA Power Networks such that, in some cases, we have immunity from civil liability, and in other cases, our liability is limited.

These immunities relate to loss and damage incurred as a result of supply interruptions, or as a result of vegetation infringement upon powerlines, provided that we have adhered to prescribed procedures.

Both of these immunities are outlined below:

(a) ***Supply interruptions***

Under section 53(1) of the Electricity Act, we have the power to disconnect supply in emergency situations without incurring liability. This is a unique power that is not available to other distribution businesses. SA Power Networks has developed a series of procedures that describe the circumstances in which we may disconnect supply in order to avert a risk of a fire starting from our infrastructure. Provided that these procedures are reasonable and strictly adhered to, we are immune from liability to anyone who may have suffered loss as a result of electricity supply being disconnected.

We exercised this power 5 times in 2019 as follows:

- Port Lincoln 5 April 2019

- Port Lincoln 11 November 2019

- Port Lincoln 20 November 2019

- Roseworthy 20 December 2019

- Woodside 20 December 2019 (at the request of the Country Fire Service).

Prior to this, we had not exercised the power for 7 years.

(b) ***Vegetation infringement upon powerlines***

Vegetation and trees form a fundamental part of our urban and rural landscape and provide a wide range of aesthetic and environmental values and benefits on both private and public land. However, there are risks associated with trees in relation to their proximity to powerlines. Consequently, SA Power Networks is required to undertake vegetation clearance to ensure community safety and the delivery of a reliable electricity supply to customers.

We have a duty under section 55(1) of the Electricity Act to remove vegetation from and around powerlines in accordance with the principles in the *Electricity (Principles of Vegetation Clearance) Regulations 2010* (SA). We set out in some detail our obligations under those Regulations in Attachment 13 – Pass through events to our Revised Proposal.

Our current approach to vegetation management that applies to bushfire and non-bushfire risk areas can be found in our *Protocol for Vegetation Management Near Powerlines 2019-2021* which is available at: https://www.sapowernetworks.com.au/public/download.jsp?id=311919.

By way of a summary, we engage a third party contractor who is a specialist in all facets of vegetation scoping and clearance, to conduct vegetation clearance operations in accordance with our regulatory vegetation clearance requirements.

In addition, we undertake the following activities:

- preparation of an Operational Vegetation Management Plan;
- approval of contractors' work plans;
- monitoring and periodic auditing of all facets of contractor work plans; and
- engagement of an external auditor to report on compliance with the Operational Vegetation Management Plan.[18]

Our Operational Vegetation Management Plan provides a means of monitoring work progress to achieve compliance, reviewing strategies, forecasting work volumes and expenditure, and implementing future initiatives to improve regulatory compliance and program efficiencies.

These factors impact upon the placement of our combined liability insurance program and the terms of the combined liability insurances that are offered to SA Power Networks and demonstrate the efficiency and prudency of our bushfire risk management and combined liability insurance procurement processes.

Current projects relating to bushfire mitigation

We have proposed a number of capital projects for the 2020-25 RCP that are aimed at mitigating the risk of a bushfire being caused by our distribution network.

For example, we proposed in our Original Proposal, and the AER approved in its draft decision, a 'bushfire mitigation' capital expenditure program which is a targeted program to manage the risk of bushfires starting from our infrastructure in high bushfire risk areas.[19] That program includes the following two elements:

[18] In addition, we also arrange operational audits, pre- and post-bushfire season audits and internal audits. The scope of those audits is set out in our underwriting submissions which have been provided in confidential Appendix 4 to the Addendum.

[19] Refer to Supporting Documents 5.13, 5.14, 5.15 and 5.16 of our Original Proposal.

- installing fast operating switches with remote control capability, which allows us to clear network faults much faster, thereby reducing the likelihood of a network fault resulting in a fire start; and

- replacing outdated surge arrestor technologies which are prone to fire starts due to their open design.[20]

However, whilst those projects will minimise our bushfire start risks, the undertaking and completion of these projects will not operate to mitigate the expected increase in bushfire liability insurance premiums. This is confirmed by the Marsh Report.

The only capital project that would have the potential to affect the expected increase in our bushfire liability insurance premiums would be a program of extensive undergrounding of our distribution lines in high bushfire risk areas. Even if we were to undertake such a program, it is not sufficiently certain that this would have a material impact on the expected increase in premiums during the 2020-25 RCP.

We have consulted with our insurance broker, Marsh, in relation to this issue and sought their expert opinion views based on their experience in securing bushfire liability insurance for other network businesses. It is clear that despite the fact that some distribution lines in the high bushfire risk areas would be underground, insurers would still view the fact that we have other electricity assets (e.g. feeders) in those areas as a risk and as such they would not be willing to significantly adjust down the premiums (if any downward adjustment was in fact offered).

In any event, we provide as much information and detail as possible to potential insurers about our bushfire mitigation strategies and actions in our underwriting submissions. Marsh has indicated that the high level of detail we provide in those submissions is viewed favourably by insurers when making decisions about which businesses should be offered their limited bushfire liability insurance capacity. This also affects the premiums payable for that insurance cover and provides us with the opportunity to secure a greater level of cover as compared to other businesses due to the insurers perceiving that our business has a relatively lower level of bushfire liability risk as compared to other businesses.

Information provided to the AER to date, and additional information

We have provided, and are continuing to provide, as much information as possible to the AER and other stakeholders in relation to the robust and extensive processes that we follow each year to secure bushfire liability insurance.[21] We provide that information in order to demonstrate the prudency and efficiency of that process, and the level of investigation and testing of the international bushfire liability insurance market that we undertake to source our insurance.

In particular, we included in confidential Annexure A to Attachment 13 of our Revised Proposal a detailed explanation of the procurement and governance processes we follow when:

- investigating the current availability of bushfire liability insurance cover; and

- reaching our final decision concerning our bushfire liability insurance program for an insurance year.

[20] Refer to Supporting Document 5.13 of our Original Proposal.

[21] Some of that information was provided to the AER in a confidential Annexure to Attachment 13 of our Revised Proposal.

[redacted]

Our insurance broker, Marsh, has prepared a further explanation of the operation of the bushfire liability section of our combined insurance policy, and this is contained in confidential Appendix 2 to this Addendum.

We also provide audited details of our total insurance costs in each Annual RIN that is provided to the AER. In order to assist the AER in assessing this Bushfire Step Change proposal, we have set out, in confidential Appendix 3, a breakdown of our historical costs for the last 10 insurance years relating to our combined liability insurance.

It is well known that insurance premiums are 'sticky', or in other words, insurance premiums tend to either increase over time or stay at the same level (even if the conditions which led to the initial increase in premium cease to apply). In other words, insurance premium rarely if ever materially decrease. Our analysis of these historical costs supports this.

As detailed in confidential Appendix 4 we have provided copies of our underwriting submissions for the last 4 years to the AER. These underwriting submissions are provided to potential insurers and provide (amongst other information) a detailed explanation concerning all issues which could potentially impact upon our management of bushfire risk. As the AER will see, each underwriting statement is a substantial document comprising nearly 200 pages of fact, figures and detailed commentary concerning our business, the risks that our business faces and the processes and procedures we have put in place to manage those risks. The feedback that we have received from the insurance market to date is that our underwriting submissions are the most comprehensive documents that the insurers receive from any of the electricity network businesses in Australia. This means that insurers are better able to assess our relative risk exposure and offer insurance that takes into account that relative risk exposure. Whilst this may not always lead to lower premiums, we think that it makes us a more attractive option for potential insurers and this could prove to be of importance if the tightening of the bushfire liability risk insurance market continues as expected.

As detailed in confidential Appendix 5 we have provided copies of our bushfire liability insurance policy statements to the AER. These submissions, together with the underwriting submissions, provide the AER with complete details of the total level of bushfire liability insurance coverage and premiums, and the structure of our deductibles and other terms and conditions.