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Dear Sirs

Submission on “Regulation of Electricity Lines Businesses – Review of the Information Disclosure Regime Discussion Paper – December 2004”

Introduction

Jardine Lloyd Thompson are international insurance brokers and risk management advisers, headquartered in London, with offices in over 30 countries.

In New Zealand we have been working with the electricity lines businesses for some time on a long term solution to the unavailability of insurance for their network assets.

We would like to make a submission regarding Insurance – Clauses 207 to 209 of the above Discussion Paper.

Background

Following September 11 (2001), insurance cover for network assets (comprising cables, lines, poles and pole mounted transformers) became unavailable to lines businesses as the global insurance market changed and placed blanket exclusions on coverage for these types of assets, along with broad exclusions for acts of terrorism.

It is our understanding from discussions with individual lines businesses that currently no company has insurance cover in place for these assets.

Previous to this some insurance cover was available, albeit for relatively small limits and high excesses and premiums, and many lines businesses were insured on this basis.

The cost of this insurance cover was expensed in the normal manner and formed part of the lines businesses’ operating cost. The current situation is therefore that the insurance cost has disappeared - but the risk has not - it is self insured, not by choice but by the decision of the insurance market.

Submission

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The insurance market now considers transmission and distribution systems (T&D) to be excluded property under Material Damage (property insurance) policies. This is as a result of exclusions placed by global reinsurers under their reinsurance treaties with insurers.

This has meant that the primary insurance market can only provide cover for T&D assets under their net retention (ie before reinsurance) and are generally very reluctant to do so.

Lines businesses in New Zealand insure some of their network assets – zone substations, major transformers, switchgear and the like – but the majority of their assets (by value) are not insured.

Some lines businesses have a small amount of insurance cover for distribution transformers located on the ground and some other switchgear, but the vast majority self insure.

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This raises two issues:

1. How do lines businesses cater for repairing or restoring their network should a large scale event occur and how will these costs be recovered?
2. Self insurance does not cost anything, until an event occurs that is. How can lines businesses protect their network assets if the insurance market will not do so?

1. Restoration

If an event, such as an earthquake, was to occur and cause substantial loss, then the lines business would need to restore supply as a first priority to the affected areas and then over time reinstate the network.

In financial terms there would be some immediate unbudgeted expenses and then undoubtedly further expenses over time as reinstatement took place.

The funds necessary to achieve restoration and reinstatement would need to come from the P&L or Balance Sheet or borrowings. In some lines businesses it would bring forward reinvestment in their network and put pressure on their pricing as they would need to recover their costs through price increases post the event.

2. Self Insurance

Self insurance has been imposed on lines businesses by the insurance market. The majority of lines businesses would insure if they could, given the value of the assets at risk and their conservative approach to risk, and did so in the past when insurance cover was available.

Lines businesses have been looking at ways to protect themselves and have looked at options such as captive insurance, special purpose funds, and most recently the mutualisation of the risk through joining together in a protection pool, much as local government does for its infrastructural assets.

Given that the self insured assets at risk amount to several billion dollars and the vast majority of these are community owned, we believe that self insurance should be a mechanism of last resort.

A solution that is being seriously considered by lines businesses at the moment is a mutual fund or pool that would provide protection for members for these uninsured assets at a nominal cost per customer per year.

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Whilst insurance costs in themselves are not material as a percentage of overall operating costs, self insurance can be expensive post event as the individual lines business must pay for their own restoration.

The new mutual fund initiative by the lines businesses will bring additional costs to the industry of between \$1.50 to \$2.00 per customer per year but will in return provide a stable long term solution to self insurance. The cost is significantly less than if each lines business attempted to do it on their own and will provide a visible cost for a risk exposure currently not catered for.

The benefit to the consumer of insurance protection vs self insurance is the ability of lines businesses to fund restoration work post event without the need to raise prices post facto. It will mean speedier recovery post event for the benefit of the consumer and will also minimise the consequential loss to the community as a whole.

Please feel free to contact the undersigned if you would like clarification on any of the above points.

Yours faithfully

David Crawford