

Essential Energy

6.04 Nominated Pass Through Event

November 2023



Table of Contents

Summary	3
1. Context to reclassification of bushfire risk on our network	3
1.1 Our obligations to manage bushfire risk	3
1.2 Our Bushfire Risk Classification System	4
1.3 Anticipated Bushfire Risk Reclassification Costs	4
1.3.1 Coronial Inquiry into 2019/20 bushfires	4
1.3.2 Material impacts of updates to the Phoenix model	5
1.3.3 Costs of changing bushfire risk management requirements will be high	5
2. New pass through event needed in the 2024-29 regulatory period	6
2.1 No provision for the Bushfire Risk Reclassification Costs in forecast opex	6
2.2 Relying on the cost pass through mechanism is appropriate in the circumstances	7
3. Nominated pass through event	8
3.1 Relevant regulatory requirements for nominated pass through events	8
3.2 Proposed Bushfire Risk Reclassification event	8
3.3 Nominated pass through event considerations	9
3.3.1 Whether the proposed event is covered by a category of pass through event specified in clause 6.6.1(a1)(1) to (4) of the NER	9
3.3.2 The type or nature of the event can be identified at the time the distribution determination is made	10
3.3.3 A prudent service provider could not reasonably prevent the event from occurring or substantially mitigate its financial effects	11
3.3.4 Service provider could not insure against the event	11
3.4 Conclusion	12

Summary

- > In this Attachment, we address the following matters raised in the Draft Decision:
 - the AER’s reluctance to accept further operating expenditure (**opex**) step changes in our Revised Proposal;¹ and
 - the AER’s rejection of certain aspects of our January 2023 Proposal in relation to nominated Pass Through Events (**PTEs**).²
- > We propose a nominated PTE for a “Bushfire Risk Reclassification Event”.
- > We will incur significant additional opex (and possibly some capital expenditure (**capex**)) during the 2024-29 regulatory period, to undertake vegetation management and other works in response to a higher bushfire risk profile on our network caused by events beyond our control. Updated bushfire modelling, used by Essential Energy and other agencies such as the Rural Fire Service, indicates that the greatest bushfire risk is moving from the south of the state to the north. Specifically, it is anticipated that:
 - the NSW Coronial Inquest /inquiries into the 2019-20 New South Wales Bushfire Season and related deaths will make findings regarding the management of bushfire risk on our network, and the model underpinning our approach to vegetation management;³ and
 - the new model for vegetation management and/or other compliance approaches arising from the NSW Coronial Inquiry will be endorsed by other stakeholders within NSW Government.
- > At this stage, however, we cannot predict the precise timing, form and cost of such event(s) and so:
 - we cannot provide for it in our forecast opex allowance in this Revised Proposal; and
 - we cannot rely on it activating any prescribed category of PTE under clause 6.6.1(a1) of the NER.
- > We are therefore compelled to nominate a PTE related to this additional expenditure and request that the AER accept this PTE in its Final Decision. We have been advised by the AER that the PTE must be cast in terms of an external driver. If the AER does not accept this PTE, then we will be prevented from recovering our prudent and reasonable costs during the 2024-29 regulatory period, and likely be penalised under the Efficiency Benefit Sharing Scheme (**EBSS**).
- > Consistent with the Draft Decision, a Bushfire Risk Reclassification Event is an unpredictable high-cost event that is caused by pre-defined exogenous circumstances that are outside the control of the business.⁴

1. Context to reclassification of bushfire risk on our network

1.1 Our obligations to manage bushfire risk

As a NSW network operator, we must comply with the *Electricity Supply Act 1995* (NSW) (**ES Act**) and its subordinate instruments (**NSW ES Supply Legislation**), including the *Electricity Supply (Safety and Network Management) Regulation 2014* (NSW) (**ES Safety Regulation**), in providing our electricity network services. Under the ES Safety Regulation, we are required to take all reasonable steps to ensure that the design, construction, commissioning, operation and decommissioning of our network (or any part of it) is safe (**ES Safety Obligation**).⁵

To comply with the ES Safety Obligation, the ES Safety Regulation requires us to develop safety management systems to support, among other matters, the management of safety risks arising from the protection of the environment (for example, preventing bushfires that may be ignited by network assets).⁶

¹ AER Draft Decision, Attachment 6, Operating Expenditure, p.4.

² See AER Draft Decision, Attachment 15, Pass Through Events.

³ The NSW Coronial Inquiry hearings concluded on 10 August 2023 and has been adjourned for Findings and Recommendations to be delivered on a date to be determined. The Livestream of the hearings and can be accessed via this link: <https://www.youtube.com/@coronerscourtofnewsouthwals5253/streams>

⁴ AER Draft Decision, Attachment 15, Pass Through Events p.1.

⁵ *Electricity Supply (Safety and Network Management) Regulation 2014* (NSW) s 5.

⁶ *Electricity Supply (Safety and Network Management) Regulation 2014* (NSW) s 6.

More specifically, the ES Safety Regulation requires us to have a safety management system in place that deals with:

- (1) the safety and reliability of the operator's network,
- (2) advice to the public about the hazards associated with electricity in relation to the operator's network,
- (3) management of bushfire risk relating to electricity lines and other assets of the operator's network that are capable of initiating bushfire,
- (4) management of bushfire risk relating to aerial consumers mains on bushfire prone land that is private land in respect of which the network operator may give directions.⁷

In answering the general principles and specifically limbs (3) and (4) above, our Vegetation Management Plan (**VMP**) is one part of the requisite safety management system and is required to ensure compliance with the ES Safety Obligation under the ES Safety Regulation.

The ES Safety Obligation, and our underlying management of bushfire risk on our network, is thus a "regulatory obligation or requirement" for the purposes of the NEL.⁸

1.2 Our Bushfire Risk Classification System

We adopt a risk-based approach when determining the appropriate degree of vegetation clearance for our network infrastructure to safeguard against bushfire risk. To this end, the implementation of our VMP relies on the probability and consequence modelling developed by the University of Melbourne in conjunction with the Rural Fire Service, known as the Phoenix RapidFire system (**Phoenix model**), to determine the bushfire risk classifications for our network. These classifications inform the vegetation clearance approach we undertake for each "vegetation bay" on our network.

Our bushfire risk classification system (**BRCS**) allocates each of the 4,183 vegetation management areas in our network footprint into one of four categories of bushfire risk:

- P1: high risk severity;
- P2: moderate risk severity;
- P3: low risk severity; and
- P4: non-bushfire prone.

In P1 risk areas, we undertake a "clear to sky" approach, meaning that all vegetation above the power line is cleared. The vegetation clearance approaches taken for P2, P3 and P4 areas are less stringent, based on the lower risk.

Essential Energy's CECG2508.15: Vegetation Management ISSC3 Compliance Demonstration Document outlines our approach to ensuring our vegetation management practices comply with the industry standard. That document also meets relevant international standards and demonstrates the propriety of the risk modelling that underpins our vegetation management practices.

This system has been the foundation of our opex calculation for our recent regulatory proposals, as approved by the AER. In other words, the notion that vegetation management costs meet the opex criteria, and should be recoverable, is uncontroversial.

1.3 Anticipated Bushfire Risk Reclassification Costs

1.3.1 Coronial Inquiry into 2019/20 bushfires

Following the devastating 2019/20 Black Summer bushfires in which livelihoods, homes and network infrastructure were lost, the NSW State Coroner began the NSW Bushfires Coronial Inquiry (**Coronial Inquiry**) on 25 August 2021.⁹

⁷ *Electricity Supply (Safety and Network Management) Regulation 2014* (NSW) s 7.

⁸ *National Electricity (NSW) Law 1997* s 2D.

⁹ Coroners Court of New South Wales, NSW Bushfires <<https://www.coroners.nsw.gov.au/upcoming-inquests/nsw-bushfires.html>>.

As part of the Coronial Inquiry, there has been specific investigation into the Darawank bushfire,¹⁰ which was one of the largest and most serious bushfires that occurred on the Mid-North Coast of NSW. The Darawank bushfire burnt approximately 3,000 hectares and destroyed or damaged at least 16 buildings.

While the Coronial Inquiry's final report is not expected until later this year or early next year, [REDACTED]
[REDACTED]
[REDACTED]

- [REDACTED]
[REDACTED]
- [REDACTED]
[REDACTED]

1.3.2 Material impacts of updates to the Phoenix model

We are undertaking substantial work to incorporate the new nationally consistent approach to network fire risk modelling using the Energy Networks Australia endorsed "IGNIS" Modelling method. The University of Melbourne's fire sciences department have assisted in running a new version of modelling, applying updated data within the Phoenix model (**Updated Phoenix model**). The result is a significant change to the high fire risk classifications within Essential Energy's footprint which we are only now beginning to fully understand.

Early indications from our application of the Updated Phoenix model are that many vegetation management areas in our footprint should be reclassified as P1 areas. This is particularly true in the North and Mid-North Coast of NSW where most areas were previously classified as P2 or P3 areas.

Areas that are classified as P1 for the first time will be subject to significant clearance and trimming programs to bring them up to the P1 standard under our VMP. In total, we estimate that over 100,000 vegetation bays will need to be upgraded to a higher bushfire risk classification (**Bushfire Risk Reclassification**). While we will undertake community engagement to assist in determining the appropriate response for managing bushfire risk in new P1 areas, we anticipate that the implementation costs will predominately be opex, with potential for some minor capital solutions.

Whilst some areas may also shift down from P1 to P2 or P3, those reclassifications are not expected to be significant and will continue to be managed to P1 clearance standards. This is to avoid incurring additional costs if these subsequently revert to P1 classification, is consistent with the practices of other networks, and also aligns with community expectations as many of these areas have been subject to extreme fires in the past.

1.3.3 Costs of changing bushfire risk management requirements will be high

Findings from the Coronial Inquiry will be important for improving public health and safety and preventing bushfires from occurring in the future (particularly in the wake of accelerated climate change impacts).

[REDACTED]
[REDACTED]
[REDACTED]

It is inevitable that we will incur costs during the 2024-29 regulatory period to [REDACTED] and to respond to the higher bushfire risk profile of our network under the Updated Phoenix model (**Bushfire Risk Reclassification Costs**).

It is prudent for Essential Energy to incur the Bushfire Risk Reclassification Costs given:

- the close nexus between the expenditure and our regulatory obligations and requirements. We will incur these costs in bringing to bear critical improvements in the management of bushfire risks for our network, as is required for the continued implementation of our VMP and, as such, compliance with our ES Safety Obligation; and
- the strong community expectation that we incur essential expenditure to observe the safety and reliability imperatives related to our network. This includes our customers expecting that we implement best practices around reducing bushfire risk for communities within our footprint, even where those practices may not be

¹⁰ Coroners Court of New South Wales, Coronial inquests/inquiries into 2019-20 New South Wales Bushfire Season and related deaths, Public Hearings – Information Paper (June 2021) p.4 <https://coroners.nsw.gov.au/documents/guides/inquiry-documents/Information_Paper_1_-_June_2021.pdf>.

mandated by any legal or regulatory obligation [REDACTED]

We recognise that, given the NSW State Coroner is yet to publish its final report and recommendations, and the response of any NSW authority remains unknown, we cannot quantify the Bushfire Risk Reclassification Costs at this time.

However, those costs will be material given:

- the geographical footprint of our network, and the susceptibility of that footprint to the accelerating impacts of climate change. We have a large network footprint, which services regional areas and spans densely vegetated areas. The susceptibility of such areas to bushfires has been emerging as a risk of accelerated climate change (with such risks now acknowledged in the National Electricity Objective (**NEO**)). The burden of the Updated Phoenix model and other relevant findings of the Coronial Inquiry will therefore be high, and the costs incurred much larger, compared to our metropolitan counterpart networks; and
- the need to effectively consult with stakeholders on our proposed management of bushfire risk in new P1 areas. In due course, we will be engaging with relevant stakeholders, which will likely include the Rural Fire Service, local councils, customers and community groups in affected areas. We will have due regard to their views on a range of matters, including habitat impacts, appropriate clearing and trimming, alternatives to tree clearances, approach to private trees etc., when deciding on the measures we will employ to meet the heightened remediation profile of our network.

We currently estimate that these costs will be in the order of \$70-80 million over the next 5 years, noting that these values are subject to further optimising of the implementation plan.

2. New pass through event needed in the 2024-29 regulatory period

2.1 No provision for the Bushfire Risk Reclassification Costs in forecast opex

Our forecast opex for the 2024-29 regulatory period, as approved in the AER's Draft Decision and included in this Revised Proposal, does not account for the Bushfire Risk Reclassification Costs.

At the time of submitting our January 2023 Proposal, we had not had an opportunity to review the Coronial Inquiry's possible findings in any detail and were not aware of the extent of reclassification of bushfire risk and additional costs resulting from the Updated Phoenix model. As such, we did not propose any forecast expenditure allowance in respect of the Bushfire Risk Reclassification Costs.

However, since becoming aware of these matters, we have indicated to the AER and customers that an opex step change, in addition to those proposed in our January 2023 Proposal, is required for the 2024-29 regulatory period to address the Bushfire Risk Reclassification Costs. Our response to the AER's 'Essential Energy Distribution Revenue Proposal Issues Paper' in May 2023, noted that we were considering introducing a new step change for "a reclassification of bushfire risk areas reflecting updated bushfire simulation modelling, meaning that vegetation costs will be higher".¹¹ This is because it had already become apparent to us that the allowance for vegetation management included in our January 2023 Proposal makes no provision for, and could in no way cover, the potential Bushfire Risk Reclassification Costs.

Despite this submission, the AER's subsequent Draft Decision, while accepting our overall step changes in costs, stated that our Revised Proposal should contain few or no step changes (as set out as an expectation in the AER's 'Better Reset Handbook').¹² In light of this, and also because the emerging nature of the Bushfire Risk Reclassification Costs means we are unable to quantify those costs in the way set out in the AER's 'Expenditure Forecast Assessment Guideline', we have not included these costs in our forecast opex.

In our view it is more appropriate, given the anticipated expenditure will be caused by events beyond our control, that we defer any decision as to our recovery of the Bushfire Risk Reclassification Costs until more information is available. This Revised Proposal therefore seeks permission to make submissions in the future to re-open our

¹¹ Essential Energy Submission to AER on the Issues Paper, p.3.

¹² AER Draft Decision, Attachment 6, Operating Expenditure, p.4.

allowable revenue in relation to the Bushfire Risk Reclassification Costs by way of the cost pass through mechanism.

2.2 Relying on the cost pass through mechanism is appropriate in the circumstances

Despite the Bushfire Risk Reclassification Costs being prudent expenditure that any responsible network operator would reasonably incur, the NER currently provides limited avenues for the recovery of these costs once our forecast expenditure allowance has been determined. Relevantly:

- there is no equivalent of a “contingent project” categorisation, as provided under clause 6.6A of the NER, for the anticipated material opex (which the Bushfire Risk Reclassification Costs are anticipated to be);
- distribution determinations can only be “re-made”, absent error, for material capex (rather than opex) arising from an uncontrollable/unforeseen event during the regulatory period, as provided under clause 6.6.5 of the NER; and
- the prescribed PTE categories under clause 6.6.1(a1) of the NER are closed and there is no guarantee those categories will capture the circumstances that cause the Bushfire Risk Reclassification Costs (as detailed further at 3.3.1 below).

We are therefore compelled to nominate a PTE related to Bushfire Risk Reclassification Costs for the 2024-29 regulatory period. The AER has the discretion to accept additional PTEs for a distribution determination under clause 6.5.10(b) of the NER and it is appropriate to do so for the reasons that follow.

First, under section 16(2) of the NEL, the AER must take into account the revenue and pricing principle (**RPP**) that a regulated network service provider should be provided with a reasonable opportunity to recover at least the efficient costs it incurs in— (a) providing direct control network services; and (b) complying with a regulatory obligation or requirement or making a regulatory payment.

The AER's Draft Decision also provides support, in the circumstances we face, for relying on a nominated PTE to recover the Bushfire Risk Reclassification Costs, as it acknowledges:

- the interrelationship between forecast expenditure allowances, on one hand, and compensation available under cost PTEs specified in a distribution determination, on the other.¹³ In circumstances where our forecast opex does not provide for the Bushfire Risk Reclassification Costs, we will not otherwise be compensated for our prudent and efficient management of emerging bushfire risk on our network (which is required to comply with the ES Safety Obligation); and
- the need to be guided, as stipulated under the NEL, by the RPP and NEO when considering nominated cost PTEs.

Critically, without a PTE related to the Bushfire Risk Reclassification Costs:

- we will be unable to recover our efficient costs related to complying with our ES Safety Obligation, as a regulatory obligation or requirement, contrary to the RPP which confirms we should have a reasonable opportunity to recover those costs;¹⁴ and
- non-recovery of costs incurred to prudently manage bushfire risk for our network would undermine our ability to efficiently operate our network in the long-term interests of electricity consumers with respect to safety and reliability, which would be contrary to the NEO.

Moreover, by accepting a nominated PTE in respect of the Bushfire Risk Reclassification Costs the AER would avoid concerns about granting an upfront opex allowance for these costs (for the reasons set out at 2.1 above). Instead, the AER could assess the expenditure at a later stage, when the Bushfire Risk Reclassification Event has occurred and once the associated costs are able to be estimated. At that time, the AER could apply its usual

¹³ AER Draft Decision, Attachment 15, Pass Through Events pp.5-6.

¹⁴ *National Electricity (NSW) Laws 7A(2)(b)*.

rigorous review of requested opex allowance under 6.6.1 of the NER, and any approved opex allowance increase would negate the impact of an inappropriate EBSS penalty.

3. Nominated pass through event

3.1 Relevant regulatory requirements for nominated pass through events

As the AER is aware, a service provider can include a proposal as to the events that should be defined as PTEs in a distribution determination, having regard to the nominated PTE considerations.¹⁵

The AER's Draft Decision did not approve all the cost PTEs we sought in our January 2023 Proposal. It is therefore open to us to seek a new Bushfire Risk Reclassification Event at this stage, both a) in response to the AER's Draft Decision, and b) now that we have become aware of this anticipated future event and the potential for associated Bushfire Risk Reclassification Costs.

Relevantly, the nominated PTE event considerations are:

- whether the proposed event is covered by a category of PTE specified in clause 6.6.1(a1)(1) to (4) of the NER;
- whether the type or nature of the event can be identified at the time the determination is made for the service provider;
- whether a prudent service provider could reasonably prevent an event from occurring or substantially mitigate its financial effects;
- whether the service provider could insure against the event, having regard to:
 - the availability (including the extent of availability in terms of liability limits) of insurance against the event on reasonable commercial terms;
 - whether the event can be self-insured on the basis that:
 - it is possible to calculate the self-insurance premium; or
 - the potential cost to the relevant service provider would not have a significant impact on the service provider's ability to offer network services; and
- any other matter which the AER considers relevant and which it has notified the network service provider is a nominated PTE consideration.

The AER must take into account these nominated PTE considerations in determining whether or not to accept a PTE nominated by a service provider.¹⁶

3.2 Proposed Bushfire Risk Reclassification event

We propose that, for the 2024-29 regulatory period, the following definition of a Bushfire Risk Reclassification Event be approved as a nominated PTE:

Bushfire Risk Reclassification Event means a direction, instruction, request or recommendation of an Authority to Essential Energy (or a class of organisation which includes Essential Energy):

- a. *that changes the manner in which bushfire risk is assessed and/or managed (compared to the manner in which bushfire risk was assessed and/or managed at the time Essential Energy submitted its regulatory proposal), including but not limited to:*
 - i. *any findings or recommendations of the NSW Bushfires Coronial Inquiry; or*
 - ii. *a direction, instruction, recommendation or request by the Independent Pricing and Regulatory Tribunal of NSW; or*

¹⁵ National Electricity Rules cl 6.5.10(a).

¹⁶ National Electricity Rules definition of 'nominated pass through event considerations'.

- iii. *the approval or endorsement by the Independent Pricing and Regulatory Tribunal of NSW of any bushfire priority zone transition plan; or*
- iv. *a direction, instruction, recommendation or request by a relevant NSW Minister; and*
- b. *that occurs on or after 1 December 2023 (being the date on which Essential Energy is no longer able to seek an allowance in its forecast operating expenditure for the 2024-29 regulatory period in respect of the costs of complying with such direction, instruction, request or recommendation); and*
- c. *that does not constitute a “regulatory change event” or “service standard event” under rule 6.6.1(a1) of the NER; and*
- d. *with which the costs of complying materially increase Essential Energy’s costs in providing direct control services.*

In this definition:

- *Authority means any government, governmental, semi-governmental, regulatory or judicial entity, statutory body, agency or authority, including any public authority constituted by or under an act, or Minister of Australian parliament;*
- *NSW Minister means a Minister of New South Wales Parliament; and*
- *NSW Bushfires Coronial Inquiry means the coronial inquiry commenced by the New South Wales State Coroner on 25 August 2021 in relation to the 2019-20 New South Wales Bushfire Season and related deaths.*

For the avoidance of doubt:

- *if more than one “event” falling within (a) above occurs:*
 - *the “Bushfire Risk Reclassification Event” may be one or more events; and*
 - *those events may be deemed as constituting one single “Bushfire Risk Classification Event”, occurring on the latest date of those events combined; and*
- *if a “Bushfire Risk Reclassification Event” occurs before 1 July 2024, an application to the AER for approval to pass through a positive pass through amount in relation to that “Bushfire Risk Reclassification Event” must be submitted within 90 business days of 1 July 2024, rather than of the “Bushfire Risk Reclassification Event” occurring, or within any extended time limit of which the AER notifies Essential Energy under clause 6.6.1(k) of the NER.*

Note: in assessing a Bushfire Risk Reclassification Event pass through application, the AER will have regard to, amongst other things:

- *the substance of any relevant direction, instruction, request or recommendation;*
- *the actions of Essential Energy in assessing the options for complying with any relevant direction, instruction, request or recommendation; and*
- *any information provided by Essential Energy to the AER about the prudence and efficiency of the costs which Essential Energy estimates are necessary to comply with any relevant direction, instruction, request or recommendation including any independent, expert report Essential Energy may commission assessing such matters.*

3.3 Nominated pass through event considerations

The Bushfire Risk Reclassification Event satisfies the nominated PTE considerations for the reasons set out below.

3.3.1 Whether the proposed event is covered by a category of pass through event specified in clause 6.6.1(a1)(1) to (4) of the NER

As discussed with the AER, the Bushfire Risk Reclassification Event has the character of being related to a regulatory obligation or requirement or service standard, given the nexus to our compliance with our ES Safety Obligation.

However, we cannot anticipate the final form of a) the Coronial Inquiry's findings or b) the response and/or endorsement of any NSW authority. As such, there remains a real risk that these exogenous developments will not result in a "change" corresponding to any category of PTE prescribed under clause 6.6.1(a1)(1) to (4) of the NER.

Most relevantly, there is a risk in our view that the Bushfire Risk Reclassification Costs would not be covered by a regulatory change or service standard event where:

- the findings of the Coronial Inquiry and/or the Updated Phoenix model, despite being relevant to us achieving ongoing compliance with our VMP and our ES Safety Obligation, may not, without more cause a change in this (or a related) regulatory obligation or requirement or have sufficient legislative or administrative character to classify as a variation, imposition or alteration in service standard; or
- additional directions are given under the NSW Electricity Supply Legislation in relation to the Coronial Inquiry and/or the Updated Phoenix model, but no NSW Authority ultimately seeks to formalise these imperatives in a way that would constitute a regulatory change or a variation, imposition or alteration of a service standard.

Having regard to this, we propose the definition of "Bushfire Risk Reclassification Event" set out at 3.2 above which:

- only captures developments of a regulatory / government character that are not captured by prescribed PTEs; and
- removes any doubt that such an event could occur where the circumstances giving rise to it would otherwise constitute a regulatory change event or service standard event, by explicitly making the carve-out.

The AER can therefore be assured that we are nominating the Bushfire Risk Reclassification Event as a "last resort" mechanism. That is, we only seek the AER's acceptance of this pass through category as a safeguard, in the event no prescribed PTE suffices, for recovering the Bushfire Risk Reclassification Costs during the 2024-29 regulatory period.

3.3.2 The type or nature of the event can be identified at the time the distribution determination is made

Nature of the event

The nature of, and circumstances that would give rise to, a Bushfire Risk Reclassification Event can be readily identified.

Our proposed definition at 3.2 above establishes a confined series of quasi-governmental exogenous "triggers", of which the occurrence of any one, where it causes a change to the manner in which we assess and/or manage bushfire risk, is a Bushfire Risk Reclassification Event. We have identified an exogenous "trigger" because this is what the AER requires.

Paragraph (a) of the proposed definition also sets out a non-exhaustive list of examples of these "triggers". These include relevant directions, instructions, requests, recommendation and/or endorsements from the Coronial Inquiry, IPART or a NSW Minister.

The rationale for nominating this category of event is to address the real possibility that a technicality would prevent us from claiming a cost pass through in respect of the Bushfire Risk Reclassification Costs, as either a "regulatory change event" or "service standard event", despite it having that character. The AER must accept a degree of adaptability within the definition of a Bushfire Risk Reclassification Event. This is the only way to ensure that the event can capture the many ways a relevant authority may exogenously cause us to comply with different and more costly requirements around bushfire risk management.

Timing of the event

We are cognisant that the Coronial Inquiry's findings and recommendations, or any quasi-governmental endorsement (as "triggers" for the Bushfire Risk Reclassification Event), may be announced either before a) the AER's final determination in April 2024 and/or b) before the next regulatory period starts on 1 July 2024.

In circumstances where any other outcome would leave us unable to recover our prudent and efficient expenditure, we wish to ensure that where the AER specifies the Bushfire Risk Reclassification Event in its final determination, the event will be eligible as a new PTE whether it happens either shortly before or after 1 July 2024.

To address this, we have proposed that the definition of Bushfire Risk Reclassification Event specifically captures "trigger" events that occur on or after 1 December 2023, and to have the time limit in which we can submit a cost pass through application, related to events that occur prior to 1 July 2024, begin from that date. While narrowly

cast, this clarification ensures that we can apply to pass through costs incurred during the 2024-29 regulatory period even where the relevant event(s) that caused those costs occur in the short window between:

- when we are precluded from seeking further expenditure allowances for the 2024-29 regulatory period (being when we submit this Revised Proposal); and
- when the AER makes its final decision (and it comes into effect).

Although we recognise that incorporating retrospective elements into the definition of a nominated PTE is novel, there is nothing in the NEL or NER that prohibits the AER from accepting such a definition.

Indeed, the AER has a broad discretion to accept proposed PTEs, where it takes into account the nominated PTE considerations (as detailed in this section 3.3).¹⁷

3.3.3 A prudent service provider could not reasonably prevent the event from occurring or substantially mitigate its financial effects

We cannot prevent, or substantially mitigate the financial effects of, a Bushfire Risk Reclassification Event occurring.

The Coronial Inquiry's findings and the anticipated impacts of the Updated Phoenix model, as well as any directions, instructions, requests, recommendation and/or endorsements a NSW authority may give in respect of those matters, are factors external to us and outside of our reasonable control.

Given that a Bushfire Risk Reclassification Event will also, as a threshold requirement, change our management of bushfire risk on our network, and by doing so, impact our compliance with our ES Safety Obligation, it would not be prudent for us to:

- ignore or avoid the event. Notwithstanding that we cannot reasonably control what the relevant decision-makers may do, it would be contrary to our regulatory obligations for us to prevent, or otherwise avoid, the application of recommendations/directions as to best practice management of bushfire risks; or
- significantly mitigate the event's cost impact on us. This could only be achieved, in respect of the Bushfire Risk Reclassification Costs, by materially reducing the extent to which we identify bushfire risk and manage safe vegetation clearances. Such an approach would be inappropriate, as not only is complying with this policy tied to our regulatory compliance, but non-compliance would also undermine a key strategy we rely on to mitigate bushfire risk (as a potential natural disaster event, which could trigger a different category of cost pass through application).

Moreover, it is appropriate that we and our customers share in efficient Bushfire Risk Reclassification Costs, as and when these become quantifiable and/or are incurred. These costs have a direct impact on managing the safety and reliability risks to our network from bushfires, which are external risks rather than business risks.

3.3.4 Service provider could not insure against the event

Commercial insurance is not available in relation to a Bushfire Risk Reclassification Event.

We are also unable to self-insure against a Bushfire Risk Reclassification Event. The precise quantum of the Bushfire Risk Reclassification Costs is currently unknown. However, as we have not included a step change for these costs in our forecast opex for the 2024-29 regulatory period, per 2.1 above, we can already be certain that the forecast expenditure allowance included in this Revised Proposal for vegetation management will provide insufficient resourcing.

The prudence of incurring the Bushfire Risk Reclassification Costs, and general nexus to our regulatory compliance as outlined at 1.3.3 above, means that we will be unable to avoid these costs should a Bushfire Risk Reclassification Event occur.

For us then to incur the Bushfire Risk Reclassification Costs, in circumstances where the cost impacts are severe, where we have no related allowable expenditure, are exposed to an EBSS penalty, and where no Bushfire Risk Reclassification event is specified, would likely result in financial distress and materially impact our ability to offer safe and reliable network services.

¹⁷ See also *National Electricity Rules* cl 6.2.6 (legislative note).

3.4 Conclusion

The nominated PTE category proposed:

- meets the *nominated PTE considerations*;
- is narrowly cast to capture external, identifiable events of a quasi-governmental character (but that do not constitute a “regulatory change event” or a “service standard event”), that will directly result in high costs to us that we cannot otherwise control or mitigate;
- simultaneously addresses the difficult timing of us becoming aware, during the period between our January 2023 Proposal and this Revised Proposal, of our likely exposure to events that will require material future expenditure and also defers to the AER’s stated preference not to be asked to approve any additional step-change scenarios in this Revised Proposal;
- is sought only for the upcoming regulatory period, which means that a Bushfire Risk Reclassification Event only needs to be approved for the 2024-29 period since ongoing compliance costs are ordinarily expected to be captured in future proposals;
- allows us to diligently and prudently address a very significant future operational risk; and
- is able to be approved by the AER as part of its broad discretions under NER 6.5.10(b) and would be consistent with the RPP and the NEO.

The AER must take into account the RPP in exercising its discretion under section 16(2) of the NEL and so must allow us the reasonable opportunity to recover our efficient costs. A reasonable opportunity includes leaving open to us the possibility of applying for a cost pass through for a Bushfire Risk Reclassification Event in the future.

Moreover, there is no downside to the AER approving this nominated category. An approval allows the AER to acknowledge the potential genuine opex impost that a Bushfire Risk Reclassification Event would precipitate, but also allows the AER to reserve its consideration as to the appropriateness of any actual expenditure until the event occurs and we have made a cost pass through application.

We respectfully request, therefore, that the AER should approve the nominated Bushfire Risk Reclassification Event as a nominated PTE, either in the form proposed by us at 3.2, or otherwise in a revised form that is satisfactory to the AER while ensuring we would have recourse to recover our efficient, yet material and prudent, expenditure during the 2024-29 regulatory period.