

# Final Decision

Essential Energy Electricity

Distribution Determination

2024 to 2029

(1 July 2024 to 30 June 2029)

Attachment A  
Contingent projects

April 2024

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#### **Amendment record**

<b>Version</b>	<b>Date</b>	<b>Pages</b>
1	30 April 2024	14

## List of attachments

This attachment forms part of the AER's final decision on the distribution determination that will apply to Essential Energy for the 2024–29 period. It should be read with all other parts of the draft decision.

The final decision includes the following documents:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 4 – Regulatory depreciation

Attachment 7 – Corporate income tax

Attachment 13 – Classification of services

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# A Contingent Project – Bushfire risk reclassification

Contingent projects are usually significant network augmentation projects that are reasonably required to be undertaken in order to achieve the capital expenditure (capex) objectives. However, unlike other proposed capex projects, the need for the project within the regulatory control period and the associated costs are not sufficiently certain. Consequently, expenditure for such projects does not form a part of the total forecast capex that we approve in this determination. Such projects are linked to unique investment drivers and are triggered by defined ‘trigger events’. The occurrence of the trigger event must be probable during the relevant regulatory control period.<sup>1</sup> The cost of the projects may ultimately be recovered from customers in the future if certain predefined conditions (trigger events) are met.

This attachment details our assessment of Essential Energy’s bushfire risk reclassification contingent project proposal as part of its revised proposal for the 2024–29 regulatory control period.

## A.1.1 AER’s final decision

Our final decision is to accept Essential Energy’s proposed bushfire risk reclassification contingent project for the 2024–29 period. We have concluded that Essential Energy’s contingent project may be reasonably required to be undertaken in order to achieve the capex objectives over the 2024–29 period.<sup>2</sup>

## A.1.2 Essential Energy’s proposal

### Proposed nominated cost pass through event

Essential Energy included a nominated cost pass through in its revised proposal for a bushfire risk reclassification event. Essential Energy submitted that it expects to incur significant operating expenditure (opex) during the 2024–29 period to undertake vegetation management and other works in response to a reclassification of its bushfire risk areas.<sup>3</sup>

Essential Energy submitted that the 2021 Coronial Inquiry into the 2019-20 Black Summer bushfires in NSW is expected to make findings relating to Essential Energy’s bushfire risk management.<sup>4</sup> Specifically, it anticipated that the findings would have regard to the modelling that underpins the risk profile for its bushfire risk management.<sup>5</sup> Essential Energy submitted that early indications from its application of the updated modelling were that many of its

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<sup>1</sup> NER, cl. 6.6A.1(c)(5).

<sup>2</sup> This is a condition precedent to our accepting a contingent project under cl. 6.6A.1(b)(1) of the NER.

<sup>3</sup> Essential Energy, *6.04 Nominated Pass Through Event*, November 2023, p. 3.

<sup>4</sup> Essential Energy, *6.04 Nominated Pass Through Event*, November 2023, p. 3.

<sup>5</sup> Essential Energy, *6.04 Nominated Pass Through Event*, November 2023, p. 3.

vegetation management areas should be reclassified from P2 or P3 (priority 2 or 3) to P1 (priority 1).<sup>6</sup>

Essential Energy submitted that it is obliged to manage bushfire risk under the Electricity Supply (Safety and Network Management) Regulation 2014 (NSW) (ES Safety Regulation).<sup>7</sup> It also submitted that, given it could not anticipate the recommendations nor the response/endorsement of any NSW authority, the NER currently provides limited avenues for it to recover its proposed bushfire risk reclassification costs.<sup>8</sup> It noted that there is no guarantee the pass through events, as defined under the NER, will capture the circumstances that would cause these costs.<sup>9</sup> As such, Essential Energy proposed a new nominated pass through event as distinct from existing prescribed pass through events.<sup>10</sup>

Since submission of its revised proposal, the NSW Coroner handed down her findings and recommendations from the 2019-20 Black Summer bushfires. The NSW Coroner made the recommendation that “..Essential take account of the relevant findings in the Inquiry including the limitations in developing and carrying out the re-model”<sup>11</sup> and also found “that Essential Energy’s BRC [Bushfire Risk Classification] system and the modelling that underpins it was not appropriate and fit for purpose in the lead up to the 2019/2020 bushfire season nor at the time this Inquiry was heard.”<sup>12</sup> The NSW Coroner also noted the progress Essential had made so far in re-modelling, observing that “Essential Energy is collaborating with the University of Melbourne to have the new system operational by the end of the 2023/2024 bushfire season. This action is indicative of positive progress.”<sup>13</sup>

We received one submission about Essential Energy’s nominated pass through proposal. CCP26 noted that Essential Energy did not engage on the price impacts of this matter, acknowledging that this may have been because of the uncertainty of the potential costs.<sup>14</sup> CCP26 suggested that Essential Energy’s nominated pass through proposal could be a more preferable approach than an opex step change if the AER thinks the change is justifiable

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<sup>6</sup> Essential Energy, *6.04 Nominated Pass Through Event*, November 2023, p. 5.

<sup>7</sup> Essential Energy, *6.04 Nominated Pass Through Event*, November 2023, p. 3.

<sup>8</sup> Essential Energy, *6.04 Nominated Pass Through Event*, November 2023, p. 7.

<sup>9</sup> Essential Energy, *6.04 Nominated Pass Through Event*, November 2023, p. 7.

<sup>10</sup> Essential Energy, *6.04 Nominated Pass Through Event*, November 2023, p. 10.

<sup>11</sup> NSW State Coroner, *Inquests and Inquiries into the 2019/2020 NSW Bushfire Season – Findings and Recommendations, Volume 1*, March 2024, p.28.

<sup>12</sup> NSW State Coroner, *Inquests and Inquiries into the 2019/2020 NSW Bushfire Season – Findings and Recommendations, Volume 2*, March 2024, p.71.

<sup>13</sup> NSW State Coroner, *Inquests and Inquiries into the 2019/2020 NSW Bushfire Season – Findings and Recommendations, Volume 2*, March 2024, p.71.

<sup>14</sup> CCP26, *Advice to AER re 2024-29 Essential Energy Revised Regulatory Proposal and AER Draft Decision*, 19 January, p. 11.

and meets regulatory requirements. This is because a nominated pass through event would manage the associated uncertainty.<sup>15</sup>

### **A.1.3 Reasons for decision**

In coming to our final decision, we have been cognisant of ensuring that Essential Energy is able to recover at least its efficient costs in the reclassification of bushfire risk areas in the face of uncertainty. We are satisfied there is a clear case for Essential Energy to be able to make additional expenditures on vegetation clearances following the higher bushfire risk classification affecting its distribution infrastructure. We consider additional expenditures will be required to manage safety risks to its infrastructure and to the public. However, we do not consider a new cost pass through event is the appropriate mechanism to quantify and recover these costs. In this section, we discuss:

- The appropriate treatment of bushfire risk reclassification costs
- A mechanism to ensure Essential Energy recovers at least its efficient costs in the reclassification of bushfire risk areas.

#### **The treatment of bushfire risk reclassification costs as capex**

In assessing the scope of works relating to the proposed bushfire risk reclassification project, we consider the costs as capex in nature for the following reasons:

- Essential Energy's proposed program of works is the establishment of a larger vegetation corridor than currently exists in the relevant areas and hence it is of the nature of augmentation
- The establishment of the vegetation clearance corridors, or the material widening (augmentation) of existing corridors, is a capital cost. This is because the proposed cost would reduce future risk from fire damage both to the existing overhead lines and from fire starts caused by the existing overhead lines. This would extend the life of the asset rather than maintain the existing life of the asset (associated with maintenance opex)
- It has been accepted practice both by the AER and by industry that the cost of vegetation corridor clearing associated with overhead line development is a capital cost.

#### **The mechanism to ensure recovery of bushfire risk reclassification costs**

We consider that Essential Energy faces specific circumstances such that a contingent project is the appropriate mechanism to ensure recovery of potential costs relating to its bushfire risk reclassification project. The circumstances are that, through Essential Energy's obligations under the ES Safety Regulation, there is uncertainty as to whether a regulatory change event has occurred or is likely to occur during the 2024-29 period.

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<sup>15</sup> CCP26, *Advice to AER re 2024-29 Essential Energy Revised Regulatory Proposal and AER Draft Decision*, 19 January, p. 11.

The ES Safety Regulation requires a network operator to have in place and implement a safety management system (SMS) that takes all reasonable steps to ensure that the design, construction, commissioning, operation and decommissioning of its network (or any part of its network) is safe.<sup>16</sup> Essential Energy submitted that the SMS includes bushfire risk management.<sup>17</sup> We note that the ES Safety Regulation also requires a network operator to review and, if necessary, modify its SMS after any significant change in relation to the safety risks to be managed by the network operator in relation to the network or in relation to the measures to be taken to manage those risks.<sup>18</sup>

It is arguable, though not without doubt, that the Coronial findings and recommendation constitute a “significant change” within the meaning of the ES Safety Regulation. There is therefore some degree of uncertainty as to whether Essential Energy is under a positive legal obligation to review and modify its SMS. The uncertainty of whether Essential Energy would be required to review and modify its SMS means that it may be unclear as to whether a regulatory change event has occurred or is likely to occur.

Further, there is also uncertainty as to when the regulatory change event occurs, if one does occur. It is unclear whether a regulatory change is triggered at the time of release of the Coroners’ report, when the re-modelling of the bushfire risk areas has occurred or when the SMS is modified. For these reasons, we considered that a regulatory change event would not be an appropriate mechanism for bushfire risk reclassification costs.

Essential Energy proposed a new nominated pass through event tailored specifically to costs arising from a reclassification of bushfire risks following the Coronial Inquiry. We do not accept Essential’s proposed “bushfire risk reclassification event”. While it is uncertain whether these circumstances amount to a regulatory change event, it is not clear that the Coronial Inquiry and following events will *not* amount to a regulatory change event. It is therefore difficult to say with certainty that the relevant events are not covered by another category of pass through event already specified in the NER.

In addition, the proposed bushfire reclassification event is not the type of event typically intended to be captured by new nominated pass through events. New nominated events are appropriate to capture categories of event, meeting the nominated pass through event criteria, that are anticipated to affect network service providers in future. The mechanism is not usually used for a single event which is known will occur once, or which has already occurred, in the manner of the proposed bushfire risk reclassification event.

We consider Essential Energy has a unique set of circumstances with its bushfire risk reclassification project. These are:

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<sup>16</sup> Electricity Supply (Safety and Network Management) Regulation 2014 (NSW), ss. 5,6 and 7.

<sup>17</sup> Essential Energy, *8.03 Proposed Contingent Project – Bushfire Risk Reclassification*, March 2024, p. 4.

<sup>18</sup> Electricity Supply (Safety and Network Management) Regulation 2014 (NSW), s. 14.



- Although there is no expectation of any legislative change including to the ES Safety Regulation, the Coronial findings and recommendation may constitute a significant change within the meaning of the ES Safety Regulation
- We consider the costs associated with Essential Energy’s bushfire risk reclassification project to be capex in nature.

For the reasons discussed, we did not consider a pass through event was appropriate for these bushfire risks. However, we consider it is reasonably likely that Essential Energy will incur reasonable additional costs for bushfire risks in the coming regulatory control period, and that these will be capital expenses. We therefore invited Essential Energy to consider whether a contingent project may be the appropriate mechanism to ensure recovery of at least its efficient costs in the reclassification of bushfire risk areas.

### **Assessment of Essential Energy’s proposed contingent project**

In March 2024, Essential Energy submitted a contingent project proposal for its bushfire risk reclassification project.<sup>19</sup> Essential Energy included potential options for the program of works, but submitted that the optimal solutions have not yet been determined.<sup>20</sup>

A contingent project should be a project that Essential Energy reasonably expects would occur in the 2024–29 period, with uncertainty related to the scope, timing and costs of the contingent project.

We reviewed Essential Energy’s proposed contingent project against the assessment criteria in the NER. We considered whether:

- the proposed contingent project is reasonably required to be undertaken in order to achieve any of the capex objectives<sup>21</sup>
- the proposed contingent project capex is not otherwise provided for in the capex proposal<sup>22</sup>
- the proposed contingent project capex reasonably reflects the capex criteria, taking into account the capex factors<sup>23</sup>
- the proposed contingent project capex exceeds the defined threshold<sup>24</sup>
- the trigger events in relation to the proposed contingent project are appropriate.<sup>25</sup>

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<sup>19</sup> Essential Energy, *8.03 Proposed Contingent Project – Bushfire Risk Reclassification*, 1 March 2024.

<sup>20</sup> Essential Energy, *8.03 Proposed Contingent Project – Bushfire Risk Reclassification*, March 2024, p. 6.

<sup>21</sup> NER, cl. 6.6A.1(b)(1). Relevantly, a distribution NSP must include forecast capex in its revenue proposal which it considers is required in order to comply with all applicable regulatory obligations or requirements, maintain the quality, reliability and security of supply, and maintain the safety of the distribution system through the provision of standard control services (see NER, cl. 6.5.7(a)).

<sup>22</sup> NER, cl. 6.6A.1(b)(2)(i).

<sup>23</sup> NER, cl. 6.6A.1(b)(2)(ii).

<sup>24</sup> NER, cl. 6.6A.1(b)(2)(iii).

When determining whether a trigger event is appropriate, we assess whether it is required:

- to be reasonably specific and capable of objective verification<sup>26</sup>
- to be a condition or event which, if it occurs, makes the project reasonably necessary in order to achieve any of the capex objectives<sup>27</sup>
- to be a condition or event that generates increased costs or categories of costs that relate to a specific location rather than a condition or event that affects the transmission network as a whole<sup>28</sup>
- to be described in such terms that it is all that is required for the revenue determination to be amended<sup>29</sup>
- to be a condition or event, the occurrence of which is probable during the 2024–29 period but the inclusion of capex in relation to it (in the total forecast capex) is not appropriate because either:
  - it is not sufficiently certain that the event or condition will occur during the regulatory control period or if it may occur after that period or not at all, or
  - assuming it meets the materiality threshold, the costs associated with the event or condition are not sufficiently certain.<sup>30</sup>

As part of our assessment, we reviewed whether the proposed contingent project is reasonably likely to be required in the 2024–29 regulatory control period based on the materiality and plausibility of the trigger events. This gives us a high-level view of whether the project is reasonably required to be undertaken in the regulatory control period in order to achieve any of the capex objectives and reflect the capex criteria.

We are satisfied that Essential Energy’s proposed bushfire risk reclassification project is a contingent project for the purpose of this revenue determination. We accept that Essential Energy would be reasonably required to incur expenditure in order to achieve the capex objectives.

Essential Energy estimates the contingent project to be in the order of \$70-80 million.<sup>31</sup> This estimate exceeds the materiality threshold of approximately \$55 million.

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<sup>25</sup> NER, cl. 6.6A.1(b)(4).

<sup>26</sup> NER, cl. 6.6A.1(c)(1).

<sup>27</sup> NER, cl. 6.6A.1(c)(2).

<sup>28</sup> NER, cl. 6.6A.1(c)(3).

<sup>29</sup> NER, cl. 6.6A.1(c)(4).

<sup>30</sup> NER, cl. 6.6A.1(c)(5).

<sup>31</sup> Essential Energy, *8.03 Proposed Contingent Project – Bushfire Risk Reclassification*, March 2024, p. 2.

Essential Energy submitted the following amended trigger events:<sup>32</sup>

1. Based on the findings of the 2022 Updated Phoenix model, Essential Energy completes a review of its Bushfire Risk Management Plan (CEOP8022) that reclassifies one or more bushfire areas of a lower rating (i.e. P2, P3, or P4 areas) to a higher rating compared to the bushfire areas defined in the 2023 fire risk prioritisation zones map contained in CEOP8022, and therefore identifies works required to comply with “ISSC3 (2016) Guide for the Management of Vegetation in the Vicinity of Electricity Assets;” and
2. Essential Energy updates its Bushfire Risk Management Plan (CEOP8022) to reflect the findings of trigger one (1) above and includes the updated plan in its Energy Network Safety Management System (ENSMS) in accordance with the requirements of the Electricity Supply (Safety and Network Management) Regulation 2014; and
3. The AER has not approved a cost pass through application for a regulatory change event or service standard event related to Essential Energy being required to amend its Bushfire Risk Management Plan (CEOP8022) prior to Essential Energy lodging an application with the AER to amend its distribution determination for the Bushfire Risk Reclassification contingent project; and
4. The AER is satisfied that Essential Energy has successfully completed a RIT-D, including an assessment of credible options, that complies with the RIT-D framework under the National Electricity Rules (NER); and
5. Essential Energy provides the AER with written confirmation from a senior manager that the Essential Energy Board has committed to proceed with and complete the Bushfire Risk Reclassification project.

We note that the third trigger ensures that if a regulatory change event occurs and Essential Energy’s revenue determination is amended to recover the incremental costs incurred as a result of that event, this would make the contingent project obsolete.

We also consider that the third trigger event (in conjunction with the contingent project proposal) provides flexibility to capture different scenarios that would allow Essential Energy to use the most relevant cost recovery mechanism in the face of uncertainty.

We consider Essential Energy’s amended trigger events are appropriate. In particular, we are satisfied that the trigger events:

- relate to specific locations that will be affected in Essential Energy’s network
- are objectively verifiable
- manage the uncertainty of whether a regulatory change event will occur
- allow for a RIT-D to determine the efficient expenditure required to achieve the capex objectives.

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<sup>32</sup> Email from Essential Energy to the AER on 3 April 2024.

We consider it is probable that Essential Energy will update its bushfire risk management plan such that it will be required to carry out works to comply with the ES Safety Regulation. Should this event occur, we accept that Essential Energy would be reasonably required to incur expenditure in order to achieve the capex objectives.<sup>33</sup>

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<sup>33</sup> NER, cl. 6.5.7(a).

## Shortened forms

Term	Definition
ACS	alternative control services
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulatory
ASP	Accredited Service Provider
capex	capital expenditure
CCP26	Consumer Challenge Panel, sub-panel 27
CESS	capital expenditure sharing scheme
CSIS	customer service incentive scheme
DER	Distributed Energy Resources
DMIAM	demand management innovation allowance mechanism
DMIS	demand management incentive scheme
DNSP or distributor	Distribution Network Service Provider
DUoS	Distribution Use of System Charges
EBSS	efficiency benefit sharing scheme
ECA	Energy Consumers Australia
ENA	Energy Networks Australia
ESB	Energy Security Board
EV	electric vehicle
F&A	framework and approach
GSL	guaranteed service level
ICT	information and communication technologies
NEL	National Electricity Laws
NEM	National Electricity Market
NEO	National Electricity Objectives
NER	National Electricity Rules
opex	operating expenditure
PIAC	Public Interest Advocacy Centre
RAB	regulated asset base
replex	replacement expenditure

Term	Definition
SAIDI	system average interruption duration index
SAIFI	system average interruption frequency index
SAPS	stand-alone power systems
SCS	standard control service
Service classification guideline	Electricity distribution service classification guideline 2018
STPIS	service target performance incentive scheme
WACC	Weighted average cost of capital