

Determination

Cost pass through Essential Energy's 2019–20 bushfire natural disaster events

March 2022

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1 Summary of our assessment

During the regulatory control period, Essential Energy can apply to pass through to its customers, in the form of higher or lower network charges, costs it incurs as a result of pre-defined exogenous events. These events are called cost pass through events. Such events are limited to circumstances where the business can recover the potential costs of defined, yet unpredictable, high cost events that are outside the control of the business.

On 28 September 2021, Essential Energy submitted a cost pass through application seeking the recovery of actual and expected costs as a result of bushfires in Northern and Southern New South Wales (NSW) that occurred between August 2019 and March 2020.

Essential Energy submitted that the 2019–20 bushfires should be classified as a single natural disaster event, noting that these fires were unprecedented in terms of their severity and impact, and that they caused severe damage to a significant part of Essential Energy's network across the east coast of NSW. Essential Energy stated that more than 3.4 million hectares were burnt in its network area, or over 60 per cent of the total fireground in NSW¹, and impacted over 104,000 customers.²

For a positive pass through to be determined in a cost pass through application, there must be a positive change event, that is:

- a pass through event specified in either the National Electricity Rules (NER) or in the current revenue determination for Essential Energy³ (in this case, a natural disaster event), and
- that event must entail Essential Energy incurring materially higher costs in providing direct control services than it would have incurred but for the event.

Essential Energy may then submit a pass through application⁴, which must address certain matters specified in the NER.⁵

We must then make a determination on Essential Energy's cost pass through application and, if a positive change event occurred, determine the approved pass through amount and the regulatory years in which the pass through amount is to be recovered from electricity consumers. In making our determination on Essential Energy's pass through application, we must have regard to certain matters specified in the NER.⁶

Our consideration of these requirements is set out in section 6 below.

In summary, we determine that the 2019–20 bushfires that are the subject of Essential Energy's application do not constitute a single natural disaster event. Instead, we determine

¹ Essential Energy, *Cost pass through application – 2019–20 bushfire season*, 28 September 2021, p. 4.

² Essential Energy, *Cost pass through application – 2019–20 bushfire season*, 28 September 2021, p. 7.

³ Cl. 6.6.1(a1) of the NER.

⁴ Cl. 6.6.1(a) of the NER.

⁵ Cl.6.6.1(c) of the NER.

⁶ Cl. 6.6.1(j) of the NER.

that the bushfires in Northern NSW and the bushfires in Southern NSW constitute two separate natural disaster events.⁷

We made this decision by taking into account all relevant circumstances, including the causes of the bushfires and assessing the geographical and temporal proximity between the various bushfires that impacted Essential Energy's network. On balance, we do not consider that all of the bushfires that impacted Essential Energy's network over the 2019–20 period were sufficiently related to constitute a single pass through event. Instead, we consider it more appropriate to characterise the Northern NSW bushfires as a separate event to the Southern NSW bushfires, particularly due to their geographical and temporal separation.

We further determine that the costs incurred by Essential Energy in providing direct control services, as a result of both the Northern NSW bushfires and the Southern NSW bushfires, respectively satisfy the materiality threshold under the NER. Therefore, we determine that two positive change events have occurred. As a result, we have considered the same scope of costs as included in Essential Energy's application for a single natural disaster event.

In relation to these two positive change events, we are satisfied that Essential Energy's cost pass through application addresses the matters required by the NER. Most notably, that the bushfire events were not caused by Essential Energy; that the costs incurred in providing direct control services as a result of the events meet the materiality threshold; and that the costs due to the bushfires were not already funded through insurance, self-insurance, or other regulatory revenues.

However, we are not satisfied that all of Essential Energy's proposed positive pass through amount of \$33.8 million (\$nominal), smoothed over 2022–23 and 2023–24, meets the requirements of the NER. Specifically, we are not satisfied that:

- the incurred fleet costs Essential Energy has included in its calculation reflect costs that are incurred solely as a consequence of the bushfire event; and
- the forecast vegetation management costs are sufficiently justified.

Accounting for these exclusions, we are satisfied that the remainder of Essential Energy's proposed positive pass through amount reflects an incremental increase in costs, and an efficient response to the Northern NSW and Southern NSW bushfires.

Our overall determination is to approve a positive pass through amount of \$11.1 million (\$nominal, smoothed) for the Northern NSW bushfires, and \$20.2 million (\$nominal, smoothed) for the Southern NSW bushfires. In total, this amounts to an incremental revenue of \$31.3 million for the two positive pass through events. This is \$2.5 million lower than Essential Energy's proposed pass through amount of \$33.8 million. The approved pass through amounts are to be recovered as follows over the two remaining regulatory years of Essential Energy's 2019–24 regulatory control period:⁸

- \$15.2 million (\$nominal) to be recovered in 2022–23, and

⁷ Section 4.1 explains why we determine that the Northern NSW bushfires and Southern NSW bushfires should be treated as separate natural disaster events.

⁸ Figures may not add due to rounding.

- \$16.0 million (\$nominal) to be recovered in 2023–24.

The approved pass through amounts reflect the recovery of the opex incurred along with the return on capital and return of capital. Therefore, the capex incurred will continue to be recovered over the life of the assets in future regulatory control periods.

The approved cost pass through amounts are estimated to incrementally increase the average annual bill of residential customers by approximately \$11 (\$nominal) and by \$42 (\$nominal) for small businesses over 1 July 2022 to 30 June 2024.

2 Introduction

We received a cost pass through application from Essential Energy for additional expenditure associated with restoring supply and repairing damage to its network caused by the 2019–20 bushfires in NSW.

As a result, Essential Energy proposed to recover from its customers additional revenues of \$33.8 million (\$nominal, smoothed), over the final two years of its current 2019–24 regulatory control period.

2.1 Who we are and our role in this process

We, the Australian Energy Regulator (AER), exist to ensure all Australian energy consumers are better off, now and in the future. Consumers are at the heart of our work, and we focus on ensuring a secure, reliable and affordable energy future for Australia. We are the economic regulator for electricity and gas distribution and transmission services in the National Electricity Market (NEM), and our electricity-related powers and functions are set out in the National Electricity Law (NEL) and the NER.⁹

Essential Energy's revenues are regulated by the AER through five year distribution revenue determinations. The current revenue determination commenced on 1 July 2019 and will finish on 30 June 2024.

We are responsible for assessing pass through applications. Under the pass through provisions in the NER, a distribution business may apply to us to seek the recovery of additional costs incurred during a regulatory control period arising from predefined events, specified in either the NER or in its revenue determination.¹⁰

2.2 Essential Energy's application

On 28 September 2021, Essential Energy submitted a cost pass through application seeking the recovery of costs it has incurred, and forecast to incur, as a result of the 2019–20 bushfires in NSW.

Essential Energy stated that more than 3.4 million hectares were burnt in its network area due to the 2019–20 bushfires, or over 60 per cent of the total fireground in NSW.¹¹ Essential Energy noted that by February 2020, over 104,000 customers had been affected by power outages from this event, including damage to over 3,200 power poles and 4,500 cross arms.¹²

⁹ In addition to regulating transmission and distribution in the NEM and the Northern Territory, we also monitor the wholesale electricity market to ensure suppliers comply with the legislation and rules, taking enforcement action where necessary, and regulate retail energy markets in Queensland, New South Wales, South Australia, Tasmania (electricity only) and the ACT.

¹⁰ Cl.6.6.1 of the NER.

¹¹ Essential Energy, *Cost pass through application – 2019–20 bushfire season*, 28 September 2021, p.4.

¹² Essential Energy, *Cost pass through application – 2019–20 bushfire season*, 28 September 2021, p.7.

Essential Energy submitted that the broad fire impact led it to undertake a holistic network response, with employees assisting from right across NSW. This involved prioritising power restoration for critical infrastructure and services, and working collaboratively with the NSW Rural Fire Service (RFS) and other authorities to coordinate the response and provide alternative power generation services as needed. This included providing large generators to evacuation centres, nursing homes and water and sewerage supplies, and also supporting residential customers by providing 165 generators¹³ to customers that were affected by substantial network damage.

Essential Energy submitted that the 2019–20 bushfires that affected its network should collectively be treated as a single natural disaster, and not multiple natural disasters, primarily due to:¹⁴

- Multitude of fires having a common underlying cause, such as climate conditions and drought.
- The NSW Government making a Natural Disaster Declaration for the NSW Bushfires from 31 August 2019 onwards.
- The NSW Government Disaster Assistance Guidelines' definition of a natural disaster event which, Essential Energy notes, expressly contemplates a combination of events (such as multiple bushfires).
- The NSW Bushfire Inquiry and the RFS confirming that a large majority of the bushfires burned over the same time.

Essential Energy stated that it expects to incur \$75.2 million (\$2020–21) in additional costs as a result of these bushfires, consisting of \$20.2 million operating expenditure (opex) and \$55.0 million of capital expenditure (capex).

Table 1 shows the additional opex and capex costs that Essential Energy has proposed to have incurred, and expects to incur, over its current 2019–24 regulatory control period as a result of the 2019–20 bushfires.

Table 1 Essential Energy's proposed expenditure related to the 2019–20 bushfires

\$million, (real 2020–21)	2019–20	2020–21	2021–22	2022–23	2023–24	Total
Operating expenditure	11.0	4.4	5.0	-0.1	-0.1	20.2
Capital expenditure	44.0	2.4	8.5	0.1	0.0	55.0
Total expenditure	55.0	6.7	13.5	0.0	-0.1	75.2

Source: Essential Energy, *Cost pass through application – 2019–20 bushfire season*, 28 September 2021.

This results in a proposed pass through amount of \$33.8 million (\$nominal, smoothed), which Essential Energy has proposed to recover over the final two years of the current regulatory

¹³ Essential Energy, *Cost pass through application – 2019–20 bushfire season*, 28 September 2021, p.14.

¹⁴ Essential Energy, *Cost pass through application – 2019–20 bushfire season*, 28 September 2021, p. 5.

control period (that is, 2022–23 and 2023–24). The proposed pass through amount reflects the recovery of the opex incurred along with the return on capital and return of capital.

2.3 Structure of this document

This document details our assessment and determination, amongst other things, on whether a positive change event has occurred, the allowable amount to be recovered, the timeframe for recovery, and our reasons for the determination.

The decision is structured as follows:

- Section 3 sets out our determination on Essential Energy’s cost pass through application.
- Section 4 sets out our reasons for the determination and our assessment of the proposed positive pass through amount.
- Section 5 sets out our assessment of the proposed recovery period of the positive pass through amount.
- Section 6 sets out our assessment of Essential Energy’s cost pass through application against the NER requirements, including whether the materiality threshold is met, and consideration of stakeholder submissions.

3 Our determination

We determine that the 2019–20 bushfires in Northern NSW and Southern NSW, which are the subject of this cost pass through application, constitute two separate positive change events. Our assessment against the requirements of the NER is summarised in Table 8 in section 6.

We determine a positive pass through amount of \$11.1 million (\$nominal, smoothed) for the Northern NSW bushfire event, and \$20.2 million (\$nominal, smoothed) for the Southern NSW bushfire event. In total, this amounts to \$31.3 million with the amounts to be recovered as follows over the two remaining regulatory years of Essential Energy’s 2019–24 regulatory control period through the X-factors set in the PTRM:

Table 2 Recovery of pass through amounts over 2022–23 and 2023–24

\$million (nominal)	2022–23	2023–24	Total
Northern NSW pass through amount	\$5.4	\$5.7	\$11.1
Southern NSW pass through amount	\$9.8	\$10.4	\$20.2
Combined pass through amounts	\$15.2	\$16.0	\$31.3

Source: AER’s analysis

Note: Figures may not add due to rounding.

Section 4 and 5, and Table 8 in section 6, sets our assessment of Essential Energy’s cost pass through application and the positive pass through amounts.

4 Reasons for determination

4.1 Occurrence of a natural disaster

The first step in our assessment is to determine whether a pass through event has occurred. A pass through event is defined in clause 6.6.1(a1) of the NER as one of the following events:

- a) a regulatory change event;
- b) a service standard event;
- c) a tax change event;
- d) a retailer insolvency event; and
- e) any other event specified in a distribution determination as a pass through event for the determination (nominated pass through event).

Essential Energy submitted that the 2019–20 bushfires qualify as a natural disaster pass through event, which is provided for, and defined as follows, in its 2019–24 revenue determination:¹⁵

“Natural disaster event means any natural disaster including but not limited to cyclone, fire, flood or earthquake that occurs during the 2019–24 regulatory control period that increases the costs to Essential Energy in providing direct control services, provided the fire, flood or other event was not a consequence of the acts or omissions of the service provider.

Note: in assessing a natural disaster event pass through application, the AER will have regard to, amongst other things:

- *Whether Essential Energy has insurance against the event,*
- *The level of insurance that an efficient and prudent NSP would obtain in respect of the event,*
- *Whether a relevant government authority has made a declaration that a natural disaster has occurred.”*

4.1.1 Treating multiple bushfires as separate natural disaster cost pass through events

Our determination is to categorise the bushfires that impacted Essential Energy’s network in the 2019–20 season as two separate natural disaster events. Essential Energy submitted that all the fires that occurred during the relevant period should be classified as a single natural disaster event, for the reasons noted in section 2.2 above. However, we determine that it is more appropriate, and consistent with the approach taken in previous cost pass

¹⁵ AER, *Final Decision: Essential Energy 2019–24 Distribution Determination – Overview*, April 2019, pp. 44-45.

through determinations, that the bushfires subject to this application be divided into two separate natural disaster events.

We had regard to Essential Energy’s submission regarding the NSW Government making a Natural Disaster Declaration for the North Coast Bushfires from 18 July 2019 onwards, and for the NSW Bushfires from 31 August 2019 onwards.¹⁶ We consider, that while a government declaration assists in determining whether a natural disaster has occurred and informs the scope of such a disaster, it is only one of the factors we will have regard to in assessing a cost pass through application. Importantly, these declarations are made for a purpose that is different to that of the cost pass through provisions in the NER, and therefore, should not be used deterministically in defining the scope of a natural disaster event.

As stated in our TransGrid 2019–20 bushfire cost pass through decision, determining whether multiple natural disasters of the same kind can be considered as a single natural disaster pass through event, is a question of fact that must be determined on a case-by-case basis having regard to all the surrounding circumstances. Additionally, we noted that depending on the nature of the natural disasters, we take into consideration the cause, geographical and temporal proximity, as well as any other relevant factors, in determining whether they are sufficiently related and can be considered as a single pass through event.¹⁷

In forming our decision on Essential Energy’s application, we sought further information from Essential Energy relating to details of individual fires that impacted its network, including the location, ignition, and extinguishing dates of individual fires.

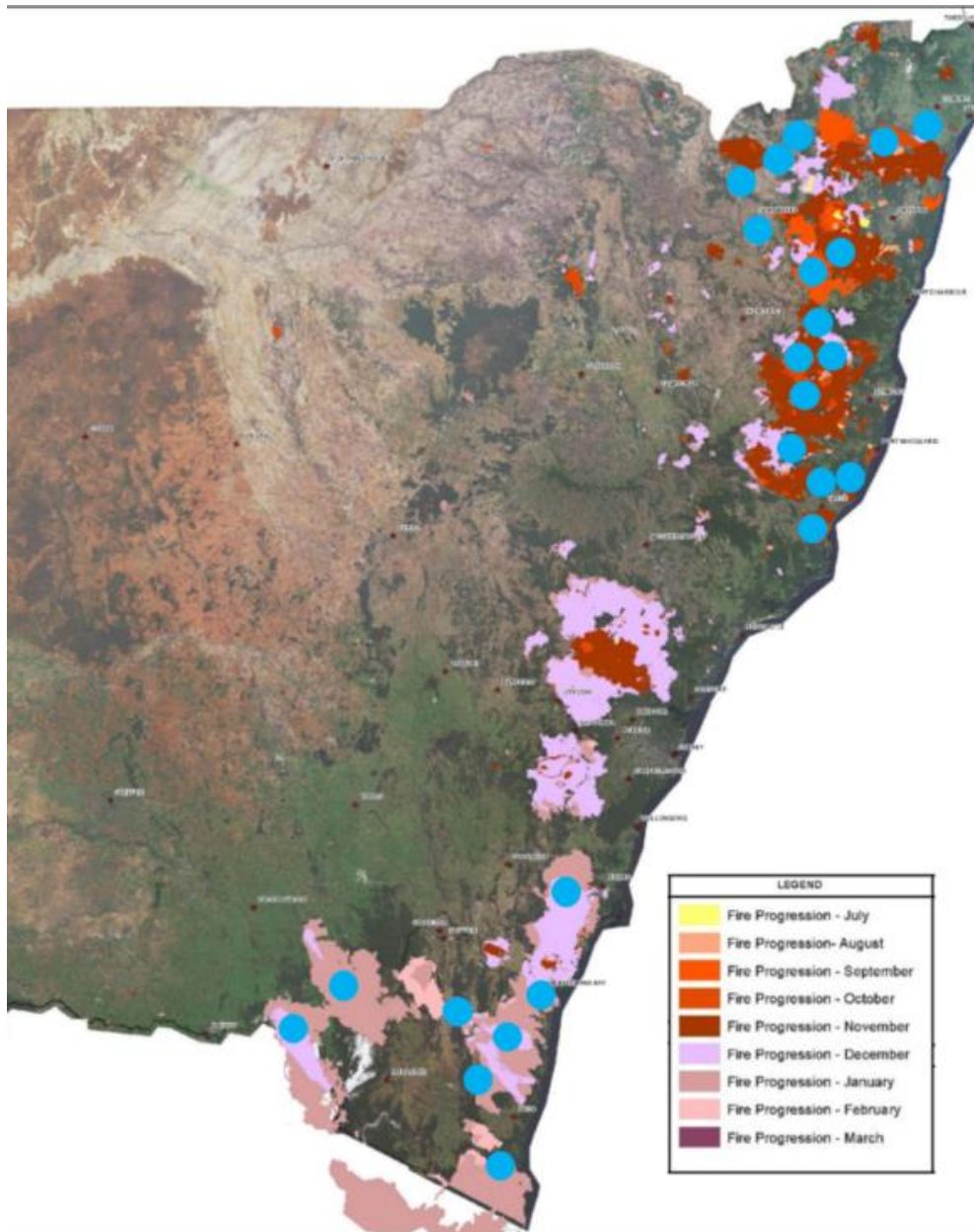
Essential Energy responded to our information notice by providing details of 24 major fires which impacted its network. It was noted that these major fires were derived through overlaying its network area with the major identified fires in the Final Report of the NSW Bushfire Inquiry. Essential Energy further highlighted that it incurred costs for other surrounding minor fires which were not identified in the report.

Figure 1 below shows the approximate location of the 24 major bushfires (blue dots) as identified in Essential Energy’s response on a map of NSW. We note that the blue dots are located in the general vicinity of the fire to show distribution across the Essential Energy network and do not represent the exact ignition points. Therefore, this map should be used for guidance purposes only.

¹⁶ Essential Energy, *Cost pass through application – 2019–20 bushfire season*, 28 September 2021, p.5.

¹⁷ AER, *Decision cost pass through: TransGrid’s 2019–20 bushfire natural disaster event*, May 2021, p. 13.

Figure 1 Map of 2019–20 bushfire burnt area within NSW and major fires that impacted Essential Energy’s distribution network



Source: Department of Premier and Cabinet NSW, *Final Report of the NSW Bushfire Inquiry*, July 2020, p. 24; AER analysis.

Figure 1 highlights two distinct geographically separate bushfire clusters exist that impacted Essential Energy’s network: one in the north of NSW, and the other in the south of NSW. This figure also emphasises the temporal differences between the bushfires in the Northern NSW and Southern NSW regions as it shows that the bushfires in Northern NSW primarily progressed in the last quarter of 2019 (red patches in Figure 1) and the bushfires in Southern NSW primarily progressed in the first quarter of 2020 (pink patches in Figure 1).

We accept that the preceding drought in NSW and extreme fire weather played a significant role in the occurrence and severity of all the NSW bushfires. However, based on the information provided to us, we are not satisfied that all the bushfires included in Essential Energy’s application are sufficiently related to each other. We consider that given the number

of distinct bushfires that impacted Essential Energy’s network and the geographical separation of major bushfires in Northern NSW and Southern NSW, it is more appropriate to treat the bushfires as two, separate natural disasters for the purpose of assessing whether a natural disaster event has occurred.

Overall, we consider that the bushfires within each of the Northern NSW and Southern NSW bushfire regions are sufficiently related to each other due to their proximity in time and location. The fires within these regions were likely to have been contributed to by the same local weather conditions. Critically, the combined proximity of time and location of the bushfires within the respective regions support an inference that they are sufficiently related.

However, we consider that the same reasoning does not link the bushfires across the Northern NSW and Southern NSW bushfire regions. Whilst acknowledging that generally common weather conditions underpinned the bushfire season, we consider that the geographical separation between the regions means that it is unlikely that the same localised weather conditions (regarding wind speed, temperature and humidity conditions) would have affected both bushfire regions around the same time or that the bushfires were propagated from or merged with the other bushfire region. Consistent with our TransGrid decision, we consider that the considerable distances between the Northern NSW and Southern NSW bushfire regions, and their respective impacts on the network, ‘break the nexus’ between the bushfires.

Therefore, we consider it more appropriate in Essential Energy’s case, that two natural disaster events occurred during the 2019–20 bushfire season: one in Northern NSW and another in Southern NSW. We note that Essential Energy’s cost pass through application also acknowledged the geographical and temporal separation between these bushfire regions by stating that: “from September 2019, multiple and concurrent fires began causing significant impacts and costs to our network in the Northern regions and this continued into January 2020. The Southern areas of our network were affected from December 2019 through to February 2020”.¹⁸

We consider that each of the two groups of bushfires impacting Essential Energy’s network satisfy the definition of a natural disaster pass through event. The events increased the costs to Essential Energy in providing direct control services and they were not a consequence of an act or omission of Essential Energy – the events were outside Essential Energy’s control and unforeseeable.

4.2 Positive change event

If we are satisfied that a pass through event has occurred, we must determine whether the pass through event qualifies as a “positive change event”. That is, whether Essential Energy incurred materially higher costs in providing direct control services than it would have incurred but for the pass through event.

¹⁸ Essential Energy, *Cost pass through application – 2019–20 bushfire season*, 28 September 2021, p.5.

The NER defines “materially” as:¹⁹

“For the purposes of the application of clause 6.6.1, an event results in a Distribution Network Service Provider incurring materially higher or materially lower costs if the change in costs (as opposed to the revenue impact) that the Distribution Network Service Provider has incurred and is likely to incur in any regulatory year of a regulatory control period, as a result of that event, exceeds 1% of the annual revenue requirement for the Distribution Network Service Provider for that regulatory year.”

After accounting for the downward adjustments we discuss in section 4.4, we consider the additional costs incurred by Essential Energy in providing direct control services as a result of the Northern NSW bushfires, and the Southern NSW bushfires, meet the materiality threshold respectively, as demonstrated in Table 3 and 4 below. As such, both the Northern NSW bushfires, and the Southern NSW bushfires, meet the definition of a positive change event.

Table 3 Materiality assessment of Northern NSW bushfires

\$million (nominal)	2019–20	2020–21	2021–22	2022–23	2023–24
Operating expenditure	3.6	1.4	2.3	0.0	0.0
Capital expenditure	12.6	1.2	0.5	0.0	0.0
Total costs	16.2	2.7	2.8	0.0	0.0
Approved unsmoothed revenue	938.5	1003.5	1020.3	1058.1	1043.6
Materiality	1.7%	0.3%	0.3%	0.0%	0.0%

Source: AER’s analysis

Table 4 Materiality assessment of Southern NSW bushfires

\$million (nominal)	2019–20	2020–21	2021–22	2022–23	2023–24
Operating expenditure	7.5	3.0	1.5	0.0	0.0
Capital expenditure	26.6	1.2	8.2	0.1	0.0
Total costs	34.1	4.2	9.7	0.0	0.0
Approved unsmoothed revenue	938.5	1003.5	1020.3	1058.1	1043.6
Materiality	3.6%	0.4%	0.9%	0.0%	0.0%

Source: AER’s analysis

4.3 Timing of Essential Energy’s application

The NER requires a Distribution Network Service Provider (DNSP) to submit a cost pass through application to us within 90 business days of the positive change event occurring. We consider that the positive change occurred on 4 March 2020 being the date the final bushfires that caused damage to Essential Energy’s network were extinguished.

Under clause 6.6.1(k) of the NER, a DNSP can request an extension to submit its cost pass through application on the grounds of difficulty in assessing and quantifying the effect of the

¹⁹ Chapter 10 of the NER, Glossary.

pass through event. Essential Energy submitted two requests for extension under this clause, one on 30 March 2020 and one on 17 July 2020. We found Essential Energy's reasons for the requests for extension were justified, and therefore we extended the timeframe by which Essential Energy could submit its cost pass through application to 14 January 2022.

By lodging its cost pass through application on 28 September 2021, we consider that Essential Energy has met the timeframe requirement stipulated under the NER.

4.4 Assessment of the pass through amounts

In assessing a pass through application, the NER requires us to take into account a range of relevant factors,²⁰ including the need to ensure that Essential Energy only recovers any actual or likely increment in costs, to the extent that such an increment is solely as a consequence of the pass through event,²¹ and that Essential Energy does not recover costs that have or will be factored into Essential Energy's annual revenue requirement.²²

We approach this assessment by ensuring, amongst other factors, that:

- the pass through amounts reflect only those costs incurred as a result of the bushfire event/s, and not business-as-usual costs, or costs of increasing the scope of network services provided by Essential Energy;
- Essential Energy is able to recover at least the efficient costs incurred in rectifying the damage to the network caused by the bushfires; and
- the pass through amounts reflect only the incremental cost of the bushfires, taking into account deductions for actual and expected cost savings that will occur as a result of works undertaken to address the bushfires. For example, the replacement of older assets damaged by the bushfires with new assets may result in lower future inspection and maintenance costs, which should be deducted from the costs to be passed through.

We are satisfied that Essential Energy's estimates of the increase in opex and capex costs due to the bushfires, excluding a portion of the fleet and vegetation management costs, are efficient. We are also satisfied that any deferred work and savings to business-as-usual costs resulting from the bushfire expenditure have been identified and accounted for in Essential Energy's pass through application and in response to our information requests.

Table 5 details our approved incremental capex and opex costs for Northern NSW and Southern NSW bushfires. The combined incremental costs for both events add to \$68.8 million (\$2020–21). This is \$6.4 million (8.5 per cent) lower than Essential Energy's proposed total costs of \$75.2 million in its application.

²⁰ Cl. 6.6.1(j) of the NER.

²¹ Cl. 6.6.1(j)(5) of the NER.

²² Cl. 6.6.1(j)(7) of the NER.

Table 5 AER approved incremental capex and opex for the Northern NSW and Southern NSW bushfires

\$million (real \$2020–21)	Northern NSW	Southern NSW
Operating expenditure	7.1	11.8
Capital expenditure	14.4	35.6
Total costs	21.4	47.4

Source: AER's analysis

Based on our costs noted in Table 5 above, our overall determination is to approve a positive pass through amount of \$11.1 million (\$nominal, smoothed) for the Northern NSW bushfires, and \$20.2 million (\$nominal, smoothed) for the Southern NSW bushfires. In total, this amounts to incremental revenue of \$31.3 million for the two positive pass through events. This is \$2.5 million lower than Essential Energy's proposed pass through amount of \$33.8 million.

The approved pass through amounts are to be recovered over the two remaining regulatory years of Essential Energy's 2019–24 regulatory control period. Table 6 details the impact of both bushfire events on incremental revenue.

Table 6 AER approved incremental revenue resulting from the 2019–20 Northern NSW and Southern NSW bushfires (\$million, nominal)

\$million (nominal)	2019–20	2020–21	2021–22	2022–23	2023–24	Total
Return on capital	-	2.2	2.3	2.8	2.7	10.0
Return of capital (regulatory depreciation)	-	-0.2	-0.2	-0.2	-0.2	-0.9
Operating expenditure	11.1	4.5	3.7	-0.1	-0.0	19.1
Net tax amount	-0.0	-0.1	-0.1	-0.2	-0.1	-0.6
Incremental annual revenue requirement (unsmoothed)	11.1	6.3	5.6	2.3	2.3	27.7
Incremental annual expected revenue (smoothed)	-	-	-	15.2	16.0	31.3

Source: AER analysis

Note: '0.0' and '-0.0' represent small non-zero number and '-' represents zero.

The smoothed and unsmoothed revenues are equal in net present value terms. The difference between the nominal unsmoothed and smoothed total revenues is explained by the time value of money.

The subsections below set out our assessment of the efficiency of the pass through amount.

4.4.1 Costs reflect only bushfire-related costs and not business-as-usual costs

We are satisfied that the costs Essential Energy has incurred, and is forecast to incur, less the adjustment to fleet and vegetation management costs (discussed below), are costs incurred solely as a consequence of the bushfires. These costs have been demonstrated to be incremental costs and separate to the business as usual costs of operating the distribution network.

Essential Energy described the process it used for isolating the bushfire-related costs it incurred from its business as usual costs as follows:²³

“The costs of the bushfires have been captured under separate project codes for bushfires, ensuring direct expenses are identifiable. Deloitte Touche Tohmatsu provided pro bono assistance in the setting up and capturing of these costs.

Deloitte were also engaged to undertake a quality assurance review to ensure the incremental costs included in this application were accurate and only related to the 2019–20 bushfires.”

We are satisfied that the allocation processes, and the associated quality assurance, used to separate bushfire-related costs adequately supports the basis that these costs relate only to activities that would be expected to occur following a bushfire event. That is, the costs relate to restoring supply and returning the network to pre-existing levels of reliability, and not to:

- the ordinary provision of network services in non-bushfire-affected areas,
- the ordinary provision of network services in bushfire affected areas after rectification of the bushfire damage, or
- expanding the scope of the network or network services.

Fleet costs

Essential Energy proposed to recover \$5.0 million (\$2020–21) for fleet costs, stating that these costs were incremental and associated with support and maintenance of fleet vehicles in response to the 2019–20 bushfires. However, we are not satisfied that these costs are all incremental costs incurred solely as a consequence of the 2019–20 bushfires.

We note that in response to our information request, Essential Energy submitted that of its total proposed fleet costs, \$4.7 million is the fleet recovery charge, and \$0.3 million is the incremental cost from the bushfire events.²⁴ Essential Energy clarified that the \$4.7 million fleet recovery charge was calculated based on total fleet costs for the business, then allocated to bushfire projects based on a rate per labour-hour charged to those projects. Essential Energy confirmed that these fleet costs would have ordinarily been recovered against planned network expenditure. We note that many fleet projects to which the recovery charge would otherwise have been allocated, in the absence of the bushfire events, have been deferred.²⁵

We do not consider this \$4.7 million to be a direct result of the bushfire events but rather allocated by Essential Energy to its bushfire expenses in accordance with its internal cost allocation methodology. Therefore, we consider the appropriate amount to include is only \$0.3 million in fleet costs as this is the incremental amount caused by the bushfire events. Accordingly, we have reduced the allowed recovery amount for fleet costs in our determination and included \$0.1 million in fleet costs for the Northern NSW bushfire event

²³ Essential Energy, *Cost pass through application – 2019–20 bushfire season*, 28 September 2021, p. 18.

²⁴ Essential Energy, *Response to information request 2-2*, 14 December 2021, p. 2.

²⁵ Essential Energy, *Response to information request 2-2*, 14 December 2021, p. 2.

and \$0.2 million for the Southern NSW bushfire event, which adds to a combined total of \$0.3 million.

Vegetation Management

Essential Energy has proposed \$4.0 million (\$2020–21) for forecast vegetation management costs in 2021–22, which is predominantly associated with the identification and removal of hazard trees. Essential Energy stated that the bushfires resulted in a change in soil composition which has increased the volume of sapling regrowth of undesirable tall-growing trees in bushfire impacted areas. This regrowth has higher fall-in risk, such as vegetation falling into energised lines, and therefore requires further vegetation management work in 2021–22 than previously planned prior to the bushfires.²⁶

In seeking clarification regarding these costs, we found that Essential Energy's proposed amount included vegetation management costs for both bushfire impacted and non-bushfire impacted spans. We have updated the calculation of forecast vegetation management costs for 2021–22 to only include the spans that were impacted by the bushfires to ensure that the approved costs reflect only the bushfire related costs. Accordingly, we have included \$1.9 million in forecast vegetation management costs in our calculation of the approved pass through amount for the Northern NSW bushfire event and \$1.0 million for the Southern NSW bushfire event, which totals \$2.9 million.

4.4.2 The bushfire-related costs represent the efficient costs to rectify damage and restore service levels

In order to assess the efficiency of the opex and capex costs identified by Essential Energy in its cost pass through application, we have examined the scope of actions and works Essential Energy has undertaken and planned in response to the bushfire event. We considered the necessity of the works and their cost, and compared this to industry standards and costs.

We reviewed the cost capture methodology and transactions data provided by Essential Energy and asked further questions to ensure that the proposed costs were incremental and efficient. In particular, we are satisfied that Essential Energy has demonstrated prudence in identifying the scope of necessary repair works to restore network service levels.

We are satisfied that the level of costs Essential Energy has incurred, and the estimates of costs it expects to incur, as a result of the bushfires (other than in respect of the fleet and vegetation management costs identified in section 4.4.1) reflect efficient costs.

We assessed Essential Energy's proposed costs in relation to the Cabramurra rebuild work in detail. These are capital works associated with restoring permanent supply to Cabramurra, Selwyn Ski Field and Selwyn communications tower in Southern NSW as the network assets supplying these customers were destroyed due to the Southern NSW bushfires. Essential Energy considered various options to replace the permanent supply to customers in Cabramurra and proposed installing a 330/11kV transformer to restore supply rather than

²⁶ Essential Energy, *Cost pass through application – 2019–20 bushfire season: Attachment H - Vegetation Management*, 28 September 2021, pp. 4-5.

reinstating the destroyed assets.²⁷ Essential Energy provided information outlining that the proposed solution would be more efficient than a like-for-like replacement.

We considered Essential Energy's option analysis, modelling of costs and benefits, and justifications for inputs and assumptions in its models. Following a detailed review of additional information provided by Essential Energy, we found that a like-for-like replacement had lower upfront costs but had lower market benefit due to higher ongoing costs in the long run. We are satisfied that Essential Energy's preferred option had the lowest net present value and represented the most efficient solution to restore permanent supply to Cabramurra.

4.4.3 Adjustments for savings to business-as-usual costs resulting from the bushfire expenditure

Essential Energy removed \$0.5 million (2020–21) in avoided costs from its cost pass through application.²⁸ We are satisfied that Essential Energy's pass through amount reflects deductions for savings to business-as-usual costs resulting from its bushfire expenditure.

Essential Energy has explained that given the firegrounds were in a relatively well-maintained part of the network, it hasn't identified any significant avoided costs. Essential Energy stated in its proposal that it cancelled four pole replacements and 460 scheduled tasks that were previously expected to occur in 2021–22 because they related to assets that were either replaced or repaired early as part of the bushfire response.²⁹

Essential Energy also identified further reductions of approximately \$0.5 million (\$2020–21) in response to our information request which consisted of:

- \$185,000³⁰ in capex savings due to identification of further cancelled tasks in 2021–22
- \$28,000³¹ in opex savings from removing the cost of installing standalone power systems at Peak Alone as they were provided at no cost to Essential Energy
- \$243,000³² in opex savings resulting from the Cabramurra rebuild work.

We have accounted for these additional reductions in our approved pass through amounts for the Northern NSW and Southern NSW bushfire events.

Based on the information Essential Energy provided, we are satisfied that our approved pass through amounts reflects only the incremental costs arising as a result of the bushfires, taking into account the deductions for actual and expected cost savings.

²⁷ Essential Energy, *Cost pass through application – 2019–20 bushfire season: Attachment F - Business Case Cabramurra - Fact Sheet*, 28 September 2021.

²⁸ Essential Energy, *Cost pass through application – 2019–20 bushfire season: Attachment L - Avoided Cost Spreadsheet*, 28 September 2021.

²⁹ Essential Energy, *Cost pass through application – 2019–20 bushfire season*, 28 September 2021, pp. 18-19.

³⁰ Essential Energy, *Response to Information request 1-Q21*, November 2021, p. 9.

³¹ Essential Energy, *Response to Information request 1-Q6*, 10 November 2021, p. 3.

³² Essential Energy, *Response to Information request 1-Q11*, 10 November 2021, p. 5.

5 Timing of cost pass through recovery

Essential Energy proposed to recover the incremental revenue arising from its cost pass through application over the remaining two years of its 2019–24 regulatory control period. This timeframe is based on feedback received by Essential Energy through its consumer roundtable forums, where consumers showed preference for Essential Energy to recover the additional costs in network charges over two years of the current regulatory period rather than a longer period because.³³

- despite a two year cost recovery having a larger pricing impact in the short run, it was nevertheless considered to be slightly cheaper in the long run and a more practical option.
- concerns and uncertainty existed regarding the 2024–29 price path, including potential bill impacts arising from wholesale electricity prices, the NSW Electricity Infrastructure Roadmap, or increased costs/frequencies of natural disasters resulting from climate change.

We are supportive of stakeholders' views and preferred cost recovery choices, and determine that Essential Energy recover the approved amounts over the final two years of its current regulatory control period, namely financial years 2022–23 and 2023–24. This smoothing profile will incrementally increase the average annual bill of residential customers by approximately \$11 (\$nominal) per year, and by \$42 (\$nominal) per year for small businesses over 1 July 2022 to 30 June 2024.

³³ Essential Energy, *Cost pass through application – 2019–20 bushfire season*, 28 September 2021, p. 20.

6 NER requirements and stakeholder submissions

For a cost pass through to be determined, there must be a positive change event that results in an eligible pass through amount. Essential Energy can then submit a pass through application, which must address certain matters specified in the NER (see Table 7 and Table 8 below). We make a determination on Essential Energy's cost pass through application, determine the approved pass through amount and the regulatory years in which that pass through amount is to be recovered. For the reasons set out in Table 7 below, we are satisfied that two positive change events have occurred, and that Essential Energy's 2019–20 bushfire cost pass through application specifies the necessary matters required by the NER.

In making our determination on Essential Energy's approved pass through amount, we must take into account certain matters specified in the NER (see Table 8). In assessing a natural disaster pass through application, we will also have regard to certain matters set out in Essential Energy's 2019–24 distribution determination. Additionally, we have also taken into account the two stakeholder submissions received on Essential Energy's cost pass through application. Our consideration of these matters is set out in Table 8 below. And, after having regard to all of the matters in Table 8 below, and throughout this decision, we make the determination set out in section 3 above.

Table 7 Requirements for determining positive change events have occurred

#	Requirement of the NER	Our consideration
1	Is the pass through event a regulatory change event, service standard event, tax change event, or retailer insolvency event? ³⁴	No
2	Is the pass through event a contingent project or a trigger event associated with a contingent project? ³⁵	No
3	Does the pass through relate to any other event specified in Essential Energy's 2019–24 distribution determination as a pass through event for that determination? ³⁶	Yes. We consider that the Northern NSW bushfires and Southern NSW bushfires respectively satisfy the natural disaster pass through event specified in Essential Energy's determination, which is defined as including fire, provided the event was not a consequence of the acts or omissions of Essential Energy. ³⁷
4	Was the pass through event a consequence of acts or omissions of Essential Energy? ³⁸	No, there is no evidence that Essential Energy's acts or omissions caused the bushfires. ³⁹ The Final Report of the NSW Bushfire Inquiry further notes that electricity providers appear to have met their statutory

³⁴ Cl 6.6.1(a1)(1)-(4) of the NER; and chapter 10 of the NER.

³⁵ See the definition of "positive change event" in chapter 10 of the NER.

³⁶ Cl. 6.6.1(a1)(5) of the NER.

³⁷ AER, *Final Decision: Essential Energy 2019–24 Distribution Determination – Overview*, April 2019, pp. 44-45.

³⁸ AER, *Final Decision: Essential Energy 2019-24 Distribution Determination – Overview*, April 2019, pp. 44-45.

³⁹ Essential Energy, *Cost pass through application – 2019–20 bushfire season*, 28 September 2021, p. 4.

		obligation regarding preventing bushfires from starting in the 2019–20 season. ⁴⁰
5	Did the bushfire pass through event entail Essential Energy incurring materially higher costs in providing direct control services than it would have incurred but for the event? ⁴¹	<p>Yes. As discussed in section 4.2, we consider the additional costs incurred by Essential Energy in providing direct control services as a result of the Northern NSW bushfires and Southern NSW bushfires meet the materiality threshold for each of these events.</p> <p>Essential Energy’s annual revenue requirement for the 2019–20 regulatory year was \$938.5 million (\$nominal), 1% of which is \$9.4 million. We consider that an efficient amount of opex and capex incurred as a result of the bushfires in Southern and Northern NSW respectively exceeds this amount in 2019–20, and therefore, the incremental costs incurred in providing direct control services as a result of both bushfire events exceeds the materiality threshold.</p>
6	Does the pass through application relate to one event or multiple events?	<p>Essential Energy submitted that the 2019–20 bushfires constituted a single natural disaster event that impacted its network.</p> <p>As discussed in section 4.1.1, we are not satisfied that all the bushfires in NSW that caused damage to Essential Energy’s network are sufficiently related to treat them as one natural disaster event.</p> <p>We consider that there are two natural disaster pass through events addressed in Essential Energy’s application.</p>
7	What is the date on which the positive change event occurred?	<p>For the purpose of complying with 6.6.1(c), Essential Energy indicates that the fires in the North burnt until they were extinguished in late January, and the fires in the South continued through to February 2020.</p> <p>We consider the date of 4 March 2020 as the date on which the positive change event occurred. This is the date the final bushfires that caused damage to Essential Energy’s network were extinguished.⁴²</p>
8	Did Essential Energy submit a written statement of its pass through application within 90 business days of the positive change event occurring? ⁴³	<p>As discussed in section 4.3, Essential Energy submitted its written statement on 28 September 2021, following the extension of time by the AER under clause 6.6.1(k) of the NER which allowed Essential Energy to submit its cost pass through application by 14 January 2022.</p> <p>Therefore, we consider that Essential Energy has submitted its written statement within the allowed timeframe.</p>

⁴⁰ Department of Premier and Cabinet NSW, *Final Report of the NSW Bushfire Inquiry*, July 2020, p. 201.

⁴¹ That is, does it meet the definition of a “positive change event” as defined in chapter 10 of the NER.

⁴² Border Fire and Badja Forest Road, Countegany Fire; Department of Premier and Cabinet NSW, *Final Report of the NSW Bushfire Inquiry*, 31 July 2020, p. 24.

⁴³ Cl. 6.6.1(c) of the NER.

9	Did Essential Energy specify details of the positive change event, including the date on which the event occurred, in its written statement? ⁴⁴	Yes. Essential Energy's written statement is available on our website. ⁴⁵
10	Did Essential Energy specify in its written statement the eligible pass through amount, the proposed positive pass through amount, and the amounts proposed to be recovered from customers in each regulatory year? ⁴⁶	Yes. Essential Energy proposed an eligible, positive pass through amount of \$33.8 million (\$nominal, smoothed) to be recovered from consumers in the final two years of the current regulatory control period: 2022–23 and 2023–24.
11	Did Essential Energy specify in its written statement evidence of the actual and likely increase in costs that occurred solely as a consequence of the positive change event? ⁴⁷	Yes. Essential Energy's pass through application (that is, its written statement) set out the costs it incurred and is forecast to incur as a result of the bushfires, as well as how it calculated its proposed pass through amount. ⁴⁸ However, we required further information on certain components to satisfy us that these were incremental and efficient costs. In response to our information requests, Essential Energy provided further information detailing costs, assumptions and workings used to calculate these amounts.
12	Was there a regulatory information instrument applicable to the pass through application? ⁴⁹	No
13	Is the pass through amount, in whole or in part, in respect of expenditure for a restricted asset? ⁵⁰	No

Table 8 Relevant matters the AER must take into account to determine the pass through amounts

	Requirement of the NER	Our consideration
14	In making the pass through determination we must take into account the matters and proposals set out in Essential Energy's written statement. ⁵¹	This decision sets out how we have taken into account the matters and proposals set out in Essential Energy's pass through application (written statement).

⁴⁴ Cl. 6.6.1(c)(1) and 6.6.1(c)(2) of the NER.

⁴⁵ <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/cost-pass-throughs/essential-energy-cost-pass-through-2019%E2%80%9320-bushfires/initiation>

⁴⁶ Cl. 6.6.1(c)(3), 6.6.1(c)(4), and 6.6.1(c)(5) of the NER.

⁴⁷ Cl. 6.6.1(c)(6) of the NER.

⁴⁸ Essential Energy *Cost pass through application – 2019–20 bushfire season*, 28 September 2021, pp. 17-19.

⁴⁹ Cl. 6.6.1(c)(7) of the NER.

⁵⁰ Cl. 6.6.1(c1) and (d2) of the NER.

⁵¹ Cl. 6.6.1(j)(1) of the NER.

15	We must take into account the increase in costs in providing direct control services resulting from the pass through event⁵²	<p>In making this determination, we take into account the increase in costs in the provision of direct control services that, as a result of the positive change events, Essential Energy incurred and is likely to incur until the end of the regulatory control period in which the positive change events occurred.</p> <p>In section 4.4 above, we set out our assessment of the costs incurred by Essential Energy as a consequence of the bushfires. We have considered the costs that Essential Energy has incurred and is likely to incur as a result of the Southern and Northern bushfires, as well as the partially-offsetting savings in future costs that are expected to occur as a result of the works in response to the bushfires.</p>
16	We must take into account the efficiency of Essential Energy's decisions and actions in relation to the risk of the event⁵³	<p>In making this determination, we take into account the efficiency of Essential Energy's decisions and actions in relation to the risk of the positive change events, including whether Essential Energy has failed to take any action that could reasonably be taken to reduce the magnitude of the eligible pass through amounts, or omitted to take any action where such action has increased the magnitude of the amounts.</p> <p>We do not have evidence to consider that Essential Energy's decisions and actions in relation to the risk of the positive change events were inefficient. Overall, we believe Essential Energy has taken reasonable and proportionate actions during the positive change events, including working collaboratively and assisting with authorities where necessary.</p> <p>Therefore, we do not consider that Essential Energy's actions increased the magnitude of the amounts.</p>
17	We must take into account the time cost of money⁵⁴	<p>In making this determination, we take into account the time cost of money based on the allowed rate of return for Essential Energy for the regulatory control period in which the pass through events occurred.</p> <p>We have used the forecast inflation rate of 2.42 per cent as determined at the April 2019 final decision for Essential Energy to calculate the figures in nominal terms for each year of the 2019–24 regulatory control period.</p>
18	We must take into account the need to ensure that the pass through amount reflects only costs incurred solely as a consequence of the bushfires	<p>In making this determination, we ensure that Essential Energy only recovers any actual or likely increment in costs to the extent that such increment is solely as a consequence of the pass through events.⁵⁵</p> <p>In section 4.4 above, we set out our assessment of the costs incurred by Essential Energy as a consequence of the</p>

⁵² Cl. 6.6.1(j)(2) of the NER.

⁵³ Cl. 6.6.1(j)(3) of the NER.

⁵⁴ Cl. 6.6.1(j)(4) of the NER.

⁵⁵ Cl. 6.6.1(j)(5) of the NER.

		<p>bushfires. We are satisfied that Essential Energy’s proposed pass through amount, less some fleet costs, adjustments for vegetation management costs and the identified avoided costs, reflect those costs incurred solely as a consequence of the Northern NSW and Southern NSW bushfires.</p>
19	<p>The AER will have regard to whether Essential Energy has insurance against the event, and whether it is the level of insurance that an efficient and prudent network operator would obtain?⁵⁶</p>	<p>Essential Energy submitted that none of the costs related to insured structures were included in this application.</p> <p>Essential Energy also submitted that it did not have insurance covering poles and wires of its network, and the insurance was limited to structures such as substations and buildings.</p> <p>Essential Energy stated that not insuring poles and wires is consistent with other network businesses, and clarified that obtaining this insurance product is difficult and expensive to obtain as few insurers are willing to provide this high risk product. The associated premiums would further consequently result in higher network charges for customers.⁵⁷</p> <p>We note that this approach to managing this risk is generally consistent with comparable peer NEM networks including those also impacted by the 2019–20 bushfires. As such, we are satisfied that it was prudent and efficient for Essential Energy to not obtain bushfire insurance cover for its poles and wires assets.</p>
20	<p>We must take into account costs already funded by customers through our five-yearly regulatory determinations</p>	<p>The NER provide that we must take into account whether the costs of the bushfires have already been factored into the calculation of the Essential Energy’s annual revenue requirement for its 2019–24 regulatory control period.⁵⁸</p> <p>We provided revenue in Essential Energy’s 2019–24 distribution determination to fund Essential Energy to inspect, maintain, and replace some of its assets. However, the bushfires resulted in the need for an additional, increased level of inspections, maintenance, and replacement above the levels forecast in our determination.</p> <p>Costs incurred as a result of bushfires or other natural disasters can be funded through our regulatory determinations by providing revenues for self-insurance provisions. However, we did not provide revenues for self-insurance provisions in Essential Energy’s 2019–24 distribution determination.</p> <p>After making the exclusions discussed in section 4.4, we are satisfied that our approved positive pass through amounts reflects the additional costs Essential Energy incurred or expects to incur as a result of the Northern NSW and</p>

⁵⁶ AER, *Final Decision: Essential Energy 2019-24 Distribution Determination – Overview*, April 2019, p. 45.

⁵⁷ Essential Energy, *Cost pass through application – 2019–20 bushfire season*, 28 September 2021, p. 15.

⁵⁸ Cl. 6.6.1(j)(7) of the NER.

		Southern NSW bushfires not otherwise provided from in the 2019–24 distribution determination.
21	We must take into account the extent to which Essential Energy’s costs have already been funded by previous pass through determinations⁵⁹	There are no relevant previous pass through determinations.
22	We must take into account any other factors that we consider relevant	<p><i>Stakeholder submissions</i></p> <p>We published Essential Energy’s pass through application on our website and sought submissions from interested stakeholders. We received submissions from Red Energy and the Public Interest Advocacy Centre (PIAC). We have considered the issues raised in submissions in making this decision.</p> <p>Red Energy submitted that Essential Energy’s cost pass through should be varied in the same timeframe as the distribution network tariff resets such that the AER may account for it in determining the Default Market Offer (DMO). Red Energy also submitted that Essential Energy’s cost pass through should be smoothed to minimise impacts to consumers.</p> <p>As discussed in section 5, our determination is to allow Essential Energy to recover the approved pass through amount over two years commencing from 2022–23. We note that the DMO for 2022–23 will take the change in network revenues due to this decision into account.</p> <p>PIAC submitted that the cost recovery should be smoothed over two years. PIAC emphasised the importance of continued consumer engagement to determine appropriate risk and associated cost allocation preferences. It further submitted that risks should be borne by those best placed to manage them, noting the opex / capex trade-offs in risk management, including efficient inter-NSP resilience collaboration.</p> <p>As discussed in section 5, we have smoothed the approved pass through amounts from the two natural disaster events over remaining two years of Essential Energy’s 2019–24 regulatory control period, based on consumer feedback received on this issue.</p>

⁵⁹ Cl. 6.6.1(j)(7A) of the NER.

Glossary

Term	Definition
AER	Australian Energy Regulator
Capex	Capital Expenditure
DMO	Default Market Offer
DNSP	Distribution Network Service Provider
NEL	National Electricity Law
NEM	National Electricity Market
NER	National Energy Rules
NSP	Network Service Provider
NSW	New South Wales
Opex	Operating Expenditure
PIAC	Public Interest Advocacy Centre
RFS	Rural Fire Service
SAPS	Standalone Power System
