Final Determination

ActewAGL Distribution cost pass through application

Vegetation management costs for the 2012–13 regulatory year

July 2014

Inquiries about this Final Determination should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001
Tel: (03) 9290 1444
Fax: (03) 9290 1457
Email: AERInquiry@aer.gov.au

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Contents

Shortened forms

Shortened Form	Full title
ACT	Australian Capital Territory
ActewAGL	ActewAGL Distribution
AER	Australian Energy Regulator
capex	capital expenditure
DNSP	Distribution Network Service Provider
NEL	National Electricity Law
NER	National Electricity Rules
NSP	Network Service Provider
opex	operating expenditure

1 Summary

The Australian Energy Regulator (AER) regulates electricity distributors in the National Electricity Market, including in the Australian Capital Territory (ACT). We do so under the National Electricity Law (NEL) and National Electricity Rules (NER). In April 2009, the AER made a distribution determination for the ACT electricity distributor ActewAGL Distribution (ActewAGL) for the regulatory control period 1 July 2009 to 30 June 2014. The AER's principal task was to set the revenue that ActewAGL can recover from the provision of direct control services during the period.

The AER's distribution determination for ActewAGL provided an amount of $3.01 million ($2012–13) for vegetation management costs as part of its total operating expenditure (opex) allowance. The AER's distribution determination also included a pass through mechanism for a 'general nominated pass through event'. This event allows ActewAGL to pass through incremental costs arising from uncontrollable and unforeseeable events that fall outside of the normal operations of the business such that prudent operational risk management could not have prevented or mitigated the effect of the event. The pass through mechanism recognises that an efficient revenue allowance cannot account for certain types of matters that are uncertain and outside of the control of the business such that they cannot be prevented or mitigated by prudent operational risk management.

ActewAGL submitted a cost pass through application to the AER in November 2013. ActewAGL's application is for a material increase in vegetation management costs as a result of an uncontrollable and unforeseeable increase in vegetation growth rates, which followed above average rainfall in the ACT. ActewAGL proposed that the additional vegetation management costs be considered as a general nominated pass through event as specified by the AER in its 2009–14 distribution determination.[1]

ActewAGL is seeking to recover an additional amount of $1.9 million ($2012–13) in additional vegetation management costs. ActewAGL submitted that, after a period of dry weather in the ACT, rainfall in 2010–11 and 2011–12 was well above the long term average and at a level not exceeded for over 20 years prior. ActewAGL submitted that the scale of vegetation growth and encroachment on clearance zones following these years of high rainfall was not apparent until its preparation for the 2012–13 bushfire season. Higher vegetation encroachment required ActewAGL to increase inspection activities and clear a greater volume of vegetation from clearance zones.[2]

ActewAGL provided little evidence of risk management action it had investigated or implemented to prevent or mitigate the effects of this event. It appeared from the information provided that ActewAGL had continued to operate with a business as usual approach to vegetation management even after it should have been apparent to ActewAGL that a significant change in vegetation growth was occurring. Accordingly, given the issues raised by the application, we issued a draft determination in relation to ActewAGL's pass through application on 6 June 2014 to allow further opportunity for ActewAGL to address issues about the application that were of concern to the AER. There is no requirement to issue a draft determination under the NER. The release of the draft determination followed a lengthy period of engagement between AER and ActewAGL staff, during which AER staff

1 ActewAGL, *Vegetation management cost pass through,* November 2013, p. 5.
2 ActewAGL, *Vegetation management cost pass through,* November 2013, p. 3.

made two requests for further information and provided ActewAGL staff with regular briefings as to the progress of the application.

In our draft determination, we came to the view that a 'general nominated pass through event', as set out in ActewAGL's distribution determination, had not occurred. We expressed the view that a general nominated pass through event, as defined in ActewAGL's determination, must be an event that falls outside the normal operations of the business, such that prudent operational risk management could not have prevented or mitigated the effect of the event. In summary, based on the evidence provided, we came to the view that ActewAGL had not demonstrated that:

- the event could not have been prevented or its effect mitigated through prudent operational risk management
- ActewAGL had undertaken prudent operational risk management which could have mitigated the effect of the proposed pass through event.

Therefore the pass through event had not occurred. We also indicated that we were not convinced that ActewAGL submitted its cost pass through application within 90 business days of the positive change event occurring as required under clause 6.6.1(c) of the NER.

ActewAGL submitted a response to our draft determination on 20 June 2014, and a further submission on 2 July 2014. ActewAGL's submissions were accompanied by a number of attachments, including advices from Jacobs Group (Australia) Pty Ltd (Jacobs). We have taken ActewAGL's response and attachments into consideration in preparing our final decision, as well as submissions made by other stakeholders and our own further analysis.

As set out in this final determination, we remain of the view that a pass through event has not occurred. We do not accept ActewAGL's construction of the pass through event definition. We are of the view that the pass through event requires an assessment of what prudent operational risk management could be undertaken by ActewAGL in the normal operations of the business, and what prudent operational risk management was in fact undertaken.

Based on ActewAGL's response to the AER's draft determination as well as our own further analysis, we remain of the view that ActewAGL did not undertake prudent operational risk management which could have prevented or mitigated the effect of the event, or that ActewAGL had undertaken prudent operational risk management. We therefore conclude that a pass through event, as defined in ActewAGL's distribution determination, has not occurred.

2 Final determination

The AER considers that ActewAGL's pass through application does not meet the criteria of a general nominated pass through event as specified in ActewAGL's distribution determination. This is because the AER is of the view that ActewAGL did not undertake prudent risk management which could have prevented or mitigated the effect of the proposed pass through event.

2.1 Structure of this final determination

The remaining sections of this final determination are structured as follows:

- Section 3 summarises the key features of ActewAGL's pass through application and the AER's reasons for its draft determination
- Section 4 describes the AER's assessment approach
- Section 5 states our concerns about the timing of the pass through application
- Section 6 explains why we are of the view that assessment of the operational risk management activities of ActewAGL is required as part of our assessment of its pass through application. Section 6 also explains why we remain of the view that ActewAGL has not undertaken prudent operational risk management which could have prevented or mitigated the effect of the event
- Section 7 covers other issues relevant to the pass through application.

3 Cost pass through application

This section discusses the regulatory requirements of the cost pass through, as well as the process undertaken by the AER prior to issuing its final determination.

3.1 Cost pass through regulatory requirements

The relevant regulatory requirements for cost pass through events are contained within the NER and the distribution determination for ActewAGL. These requirements are set out in detail in the AER's draft determination.[3]

In its distribution determination for ActewAGL, the AER nominated the following general pass through event for ActewAGL:[4]

> A general nominated pass through event occurs in the following circumstances:
>
> - an uncontrollable and unforeseeable event that falls outside of the normal operations of the business, such that prudent operational risk management could not have prevented or mitigated the effect of the event, occurs during the next regulatory period
>
> - the change in costs of providing distribution services as a result of the event is material, and is likely to significantly affect the DNSP's ability to achieve the operating expenditure objectives and/or the capital expenditure objectives (as defined in the transitional chapter 6 rules) during the next regulatory control period
>
> - the event does not fall within any of the following definitions:
>
> > 'regulatory change event' in the NER (read as if paragraph (a) of the definition were not a part of the definition);
> >
> > 'service standard event' in the NER;
> >
> > 'tax change event' in the NER;
> >
> > 'terrorism event' in the NER;
> >
> > 'feed–in tariff direct payment event' in this final decision;
> >
> > 'smart meter event' in this final decision (read as if paragraph (a) of the definition were not a part of the definition);
> >
> > 'emissions trading scheme event' in this final decision (read as if paragraph (a) of the definition were not a part of the definition.
>
> For the purposes of this definition:
>
> - an event will be considered unforeseeable if, at the time the AER makes its distribution determination, despite the occurrence of the event being a possibility, there was no reason to consider that the event was more likely to occur than not to occur during the regulatory control period
>
> - 'material' means the costs associated with the event would exceed 1 per cent of the smoothed revenue requirement specified in the final decision in the years of the regulatory control period that the costs are incurred.

[3] AER, *Draft determination, ActewAGL distribution cost pass through application – vegetation management costs for the 2012–13 regulatory year,* June 2014, pp. 9-10.

[4] AER, *ActewAGL distribution determination 2009-14*, April 2009, pp. 136-137.

3.2 ActewAGL pass through application

On 1 November 2013, ActewAGL submitted its cost pass through application to the AER to pass through additional expenditure to its distribution network users. The expenditure relates to a material increase in vegetation management costs in 2012–13. ActewAGL submitted that it experienced this material increase in vegetation management costs due to the uncontrollable and unexpected increase in vegetation growth following two years of above average rainfall.[5]

In particular, ActewAGL submitted that:[6]

> After a period of dry weather the ACT experienced two very wet years with annual rainfall in 2010–11 and 2011–12 reaching 867mm and 778mm, well above the long term average of 620mm and at a level not exceeded since 1988–89, over 20 years prior.
>
> The scale of vegetation growth and encroachment on clearance zones following these years of high rainfall was not apparent until ActewAGL's preparation for the 2012–13 bushfire season.
>
> ActewAGL's ground inspection crews and aerial surveys indicated that the higher rainfall had shortened the time taken for vegetation to regrow into clearance zones. Higher vegetation encroachment required ActewAGL to increase inspection activities and clear a greater volume of vegetation from clearance zones.
>
> The unexpected and uncontrollable increase in vegetation growth materially increased ActewAGL's 2012–13 vegetation management (inspection and clearance) costs by $1.9m above the allowance in the Australian Energy Regulator's (AER) 2009–14 ACT Distribution Determination. The change in costs represents 1.07 per cent of ActewAGL's 2012–13 annual revenue requirement.

ActewAGL submitted that the proposed cost pass through event falls into the general nominated pass through event definition in the AER's distribution determination. ActewAGL reasoned that the event is uncontrollable and unforeseeable, the change in cost is material, and the event does not fit into any other definition defined in the NER or the AER's distribution determination.[7]

Further information regarding ActewAGL's cost pass through application is set out in the AER's draft determination.[8]

3.3 Engagement with ActewAGL prior to draft determination

After a preliminary assessment of ActewAGL's pass through application in late 2013, we considered that further information was required in order to assess the application. We wrote to ActewAGL on 2 December 2013 requesting further information and ActewAGL submitted a response on 19 December 2013.

After considering ActewAGL's response, we made a second information request on 17 January 2014. On 12 February 2014 ActewAGL responded to this request. We consider the time frame for assessing ActewAGL's pass through application as specified in the NER commenced on this date.

Following receipt of ActewAGL's response to the second information request, AER staff had a number of discussions with ActewAGL staff regarding progress of the pass through application. These

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[5] ActewAGL, *Vegetation management cost pass through,* November 2013, p. 4.
[6] ActewAGL, *Vegetation management cost pass through,* November 2013, p. 3.
[7] ActewAGL, *Vegetation management cost pass through,* November 2013, pp. 6-11.
[8] AER, *Draft determination, ActewAGL distribution cost pass through application – vegetation management costs for the 2012–13 regulatory year,* June 2014, pp. 9-12.

discussions allowed ActewAGL staff to ask questions and understand the AER's concerns regarding the pass through application. In response to the issues raised in these discussions AER staff provided ActewAGL with the modelling on which some of its analysis was based on 1 May 2014.

3.4 AER's draft determination

Given the issues raised by the application, the AER decided to publish a draft determination in relation to ActewAGL's pass through application. There is no requirement under the NER to publish a draft determination, however we were of the view that a draft determination would be of assistance in this case. The draft determination was provided to ActewAGL on 6 June 2014 and published on the AER website on 20 June 2014.

Our draft determination was that we would not approve ActewAGL's pass through. In our draft determination, we indicated that we were not convinced that ActewAGL submitted its cost pass through application within 90 business days of the positive change event occurring, as required under clause 6.6.1(c) of the NER. We also considered that ActewAGL's cost pass through application did not meet the criteria of a general nominated pass through event as specified in ActewAGL's distribution determination. In particular, in our view, ActewAGL had not established that prudent operational risk management could not have prevented or mitigated the effect of the event.[9]

Submissions on our draft determination closed on 20 June 2014. We received three submissions in response to our draft determination:

- Major Energy Users (MEU) supported the AER's draft determination position. The MEU raised concerns about the precedent set by cost pass through events of this nature and whether consumers would receive the benefit of a negative cost pass through event in relation to vegetation management costs under drought conditions.
- Aurora Energy Pty Limited (Aurora Energy) expressed concern that the AER had taken the GHD report out of context and that any reliance on the GHD report could not be extended to the draft determination without understanding the particular circumstances of ActewAGL.[10] Aurora Energy suggested that if the AER wished to fully understand the contracting model adopted by ActewAGL that an independent review taking in the circumstances of ActewAGL should be undertaken. Further, Aurora Energy considered that the AER should not create a precedent whereby the circumstances of a particular Network Service Provider (NSP) can be applied to any other NSP without taking into account any particular differences.
- ActewAGL submitted that its cost pass through application and proposed pass through amount should be approved in full. In particular ActewAGL stated that:
    - it submitted its cost pass through application within the required timeframe in clause 6.6.1(c) of the NER

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[9] AER, *Draft determination, ActewAGL distribution cost pass through application – vegetation management costs for the 2012–13 regulatory year,* June 2014, p. 8.

[10] Aurora Energy, *Submission on the AER's draft determination on ActewAGL's cost pass through application*, 20 June 2014.

- the AER erroneously interpreted and applied the requirement for a general nominated pass through event
- its decisions and actions in respect of the proposed pass through event were efficient.

3.5 Engagement with ActewAGL after the draft determination

On 27 June 2014, the AER provided ActewAGL with two public documents which formed part of Essential Energy's regulatory proposal for the 2014-19 regulatory control period. We invited ActewAGL to provide comments on those documents. On 2 July 2014, ActewAGL provided the AER with its submission on the two Essential Energy documents. ActewAGL submitted that it had not identified anything in the documents that would provide the AER with any basis to reject ActewAGL's cost pass through application or to reduce the quantum of the proposed positive pass through amount.

4 Assessment approach

When assessing ActewAGL's positive pass through application, we must first determine whether a 'positive change event' occurred. We do this by reference to the current distribution determination for ActewAGL (that defines the cost pass through events ActewAGL can utilise during the regulatory control period) [11] and the NER. As part of this process, we also determine the materiality of the proposed pass through amount.

If we are satisfied that a positive change event has occurred, we then determine the proposed pass through amount taking into account the factors set out in clause 6.6.1(j) of the NER.

4.1 Assessment approach

Under clause 6.6.1 of the NER, if a positive change event occurs, ActewAGL may seek approval of the AER to pass additional costs through to users. Chapter 10 of the NER defines a positive change event for a Distribution Network Service Provider (DNSP) as:

> For a Distribution Network Service Provider, a pass through event which entails the Distribution Network Service Provider incurring materially higher costs in providing direct control services than it would have incurred but for that event, but does not include a contingent project or an associated trigger event.

Once we determine a positive change event has occurred we must then determine:

- the approved pass through amount; and
- the amount of that approved pass through amount that should be passed through to distribution network users in each regulatory year during the regulatory control period.[12]

We do this taking into account the factors set out in clause 6.6.1(j) of the NER.

4.2 What we considered in making this determination

We have made our final determination in accordance with clause 6.6.1 of the NER. As the AER considers that a positive change event has not occurred, we have not determined an approved pass through amount.

In forming our final determination, we have:

- considered the application and supporting information we received from ActewAGL
- considered submissions received on our draft determination[13]
- undertaken our own analysis to verify and assess the information provided by ActewAGL.

The AER's Technical Advisor Group (TAG) provided advice that was used in our consideration of ActewAGL's application.[14] The TAG is an internal group of experts that provides the AER with insight

11 AER, *Draft determination, ActewAGL distribution cost pass through application – vegetation management costs for the 2012–13 regulatory year,* June 2014, pp. 9-10.

12 NER, clause 6.6.1(d).

13 These submissions are summarised in section 3.4.

and advice into electricity supply industry decision making, design and operating practices and costs. The TAG produced a report in response to ActewAGL's submission on our draft determination which is attached as confidential appendix A.[15] A redacted version of the TAG report is at appendix B.

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[14] The Curriculum Vitae for the TAG advisors is attached to our draft determination.

[15] AER Technical Advisory Group, *Targeted technical advice,* 30 June 2014.

5 Timing of the cost pass through application

In our draft determination we indicated we were not convinced that ActewAGL submitted its cost pass through application within 90 business days of the positive change event occurring as required under clause 6.6.1(c) of the NER.[16]

ActewAGL's submission on the draft determination indicates that it has given further and more detailed consideration to the correct construction of clause 6.6.1(c) of the NER. ActewAGL submitted that this clause establishes a temporal requirement that the written statement must be submitted to the AER within 90 business days of an event satisfying the definition of a positive change event occurring.[17] The definition of a positive change event includes a requirement that the DNSP is incurring materially higher costs in providing direct control services than it would have incurred but for the event.[18]

We have considered the arguments ActewAGL has raised about the timing of its cost pass through application in its submission. However, we still have concerns about when the positive change event became apparent to ActewAGL. In ActewAGL's November 2013 pass through application it stated that it submitted the application within 90 days of 30 June 2013.[19] In its response to the draft determination, however, ActewAGL stated that it was not until 10 October 2013 that it became aware that increased vegetation management costs were likely to be material.[20] We note that the processing of vegetation management costs, along with any subsequent analysis, would have occurred at the end of both the 2010–11 and 2011–12 financial years. ActewAGL has provided no information to the AER about the outcomes of any such analysis for these financial years. ActewAGL's application in relation to increased vegetation growth is only for the 2012–13 financial year, although it appears from our analysis that significant vegetation growth was occurring prior to the 2012–13 financial year and ActewAGL were aware of this.

We are aware that there may be some difficulty in determining when a pass through event results in a business incurring materially higher costs. However, the AER remains concerned that, on the information available, it is not clear that ActewAGL submitted its application within the required timeframe. In any case, we do not consider that this issue is determinative in this matter as we are not satisfied that that application has met the criteria for a general nominated pass through event on other grounds.

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16 AER, *Draft determination, ActewAGL distribution cost pass through application – vegetation management costs for the 2012–13 regulatory year,* June 2014, p. 15.

17 ActewAGL '*Vegetation management cost pass through application: ActewAGL response to the AER draft determination*', June 2014, p.4.

18 See NER – definition of 'positive change event' in chapter 10.

19 ActewAGL, *Vegetation management cost pass through,* November 2013, p. 5.

20 ActewAGL '*Vegetation management cost pass through application: ActewAGL response to the AER draft determination*', June 2014, p.5.

6 Occurrence of a general nominated pass through event

ActewAGL's 2009 distribution determination sets out the requirements for a general nominated pass through event. Whether an event can be considered a general nominated pass through event depends on three components:

- whether the event is uncontrollable and unforeseeable, falling outside the normal operations of the business, such that prudent risk management could not have prevented or mitigated the effect of it
- whether the change in cost is material and is likely to significantly affect the DNSP's ability to achieve the opex objectives and/or the capex objectives
- whether the event falls into any other relevant definition in the NER or ActewAGL's distribution determination.

The AER considers that ActewAGL's cost pass through application does not meet the requirements of ActewAGL's distribution determination. As such, a general nominated pass through event has not occurred.

6.1 Uncontrollable and unforeseeable event which could not be prevented or mitigated by prudent operational risk management

ActewAGL described the proposed pass through event as the uncontrollable and unforeseeable increase of vegetation growth following two years of above average rainfall.[21] We agree that the event described in ActewAGL's cost pass through application is uncontrollable and unforeseeable if read in isolation from the remainder of the definition of the event. However, to meet the definition it will only be uncontrollable to the extent that prudent operational risk management could not prevent or mitigate the effect of the event.[22] This latter requirement is an essential element of the definition.

The full definition of a general nominated pass through event in ActewAGL's distribution determination states that:

> A general nominated pass through event occurs in the following circumstances:
>
> - an uncontrollable and unforeseeable event that falls outside of the normal operations of the business, such that prudent operational risk management could not have prevented or mitigated the effect of the event, occurs during the next regulatory period

In its response to the draft determination, ActewAGL submitted that the AER has misinterpreted this definition. In relation to the second half of the pass through criteria, ActewAGL submitted that the AER *'mistakenly enquires into whether ActewAGL has undertaken all steps available to it to mitigate the*

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21 ActewAGL, *Vegetation management cost pass through,* November 2013, p. 4.

22 This is discussed further in the draft determination. AER, *Draft determination, ActewAGL distribution cost pass through application – vegetation management costs for the 2012–13 regulatory year,* June 2014, pp.16-18.

pass through event on the basis that a general pass through event only occurs when a DSNP has done this.'[23]

ActewAGL submitted that the event requirement only has one limb and that the AER has broken it up into separate requirements which depart from the intent of the requirement. This approach, according to ActewAGL, would render the pass through event redundant. This is because there would theoretically always be scope for a DNSP to mitigate the cost impact of an event after it has occurred.[24] ActewAGL further submitted that the risk management actions of ActewAGL are only relevant to the quantum of the pass through amount and not relevant to whether a pass through has occurred.[25]

Importantly, our view is that the second half of the pass through event definition qualifies the first. In order to satisfy the full pass through definition, ActewAGL must submit information to demonstrate that the entire requirement is satisfied, not just that the event is unforeseeable. To satisfy the test, ActewAGL must establish that the event falls outside of the normal operations of the business such that prudent operational risk management could not have prevented or mitigated the effect of the event. If ActewAGL does not provide the evidence to demonstrate that prudent operational risk management could not have prevented or mitigated the effect of the event, then the test is not met. This requires an assessment of:

- what prudent operational risk management could be undertaken by ActewAGL; and
- what operational risk management was in fact undertaken by ActewAGL.

If we were to accept ActewAGL's construction of the pass through event definition, i.e. that the second half of the definition merely '*adds content to the requirement that there be an uncontrollable and unforeseeable event',* then the second half of the definition would effectively be redundant. It would add no value to the pass through definition. Our view is that the second half of the definition actually has 'work to do', and requires some assessment of the operational risk management activities of the business in question. An event, while unforeseeable, will not qualify as a pass through event to the extent that prudent operational risk management could be undertaken in the normal operations of the business to prevent or mitigate the effect of the event.

This view logically supports both the intent of the pass through regime as well as the broader regulatory framework which provides incentives to regulated firms to manage and operate their networks efficiently. Despite being unforeseeable, in many cases it will still be possible for distribution businesses to prevent or mitigate the effect of particular events, through appropriate business practices, and for these to be managed within the overall expenditure allowance. Consumers should only bear the cost of pass through events where the business is able to show that prudent operational risk management could not have prevented or mitigated the effect of the event.

We are not of the view that the requirement to undertake prudent operational risk management necessitates ActewAGL undertaking all steps available to it to mitigate the pass through event. The

23 ActewAGL '*Vegetation management cost pass through application: ActewAGL response to the AER draft determination*', June 2014, p.8.

24 ActewAGL '*Vegetation management cost pass through application: ActewAGL response to the AER draft determination*', June 2014, p.9.

25 ActewAGL '*Vegetation management cost pass through application: ActewAGL response to the AER draft determination*', June 2014, pp.9-10.

definition refers to 'prudent operational risk management'. For instance, it may be that no prudent operational risk management could be undertaken by ActewAGL to prevent or mitigate the effects of the event. Alternatively, it may be that prudent operational risk management could be, and was, undertaken by ActewAGL. In either case, ActewAGL is required to establish that this limb of the test is satisfied, just as it must do so in relation to the other limbs of the test.

As part of our assessment, we have considered ActewAGL's operational risk management. We consider that ActewAGL's actions are relevant to a consideration of whether the pass through requirement, as set out in ActewAGL's distribution determination, has been met. This is discussed in more detail below.

6.2 What is prudent operational risk management

Vegetation management involves significant costs for service providers, and in turn, consumers. It is also a very important activity for the reliability, safety and security of networks. We therefore consider it is prudent for service providers to appropriately monitor both vegetation growth and the costs of vegetation management. We think this is especially the case after sustained periods of above average rainfall. We consider it is prudent to respond in a timely manner to evidence of significant vegetation growth, by investigating means of preventing or mitigating the effects of the vegetation growth and the additional costs that might otherwise result. It would be prudent to have a management strategy that allows appropriate recognition that an event is occurring and which provides for pre-emptive actions to prevent or mitigate the effect of significant vegetation growth or to undertake appropriate action to put in place such a strategy at the first opportunity after an event should reasonably have come to the service provider's attention.

Based on ActewAGL’s cost pass through application, we are not satisfied that it has undertaken prudent operational risk management to prevent or mitigate the costs of increased vegetation growth. In its submission, ActewAGL sets out that it has identified several actions taken to reduce the magnitude of the event. These actions include reprioritisation of labour, using new technology to increase productivity, and continuing to reinforce community awareness of the vegetation clearance requirements.[26] Each of these actions are assessed below:

Reinforcing community awareness

ActewAGL's initial application stated that reinforcing community awareness encouraged property occupants to be proactive in maintaining vegetation on their land. This in turn helps to reduce the number of notices to clear vegetation issued to property occupants by ActewAGL's urban inspection crews and increases inspection rates.[27] We agree that reinforcing community awareness may have had an impact on the number of first notices issued, however because ActewAGL is not responsible for vegetation cutting in urban areas,[28] community awareness would have only had a minimal impact on mitigating the proposed pass through event. ActewAGL's proposed cost pass through amount consists largely of an increase in contractor costs for vegetation cutting rather than inspection costs in

26 ActewAGL ‘*Vegetation management cost pass through application: ActewAGL response to the AER draft determination*’, June 2014, pp. 15–17.

27 ActewAGL, *Vegetation management cost pass through,* November 2013, p. 18.

28 See s. 109 of the *Utilities Act 2000 (ACT)*.

urban areas. Although ActewAGL has included an increase in 'other costs' arising from an increase in disposable materials required in issuing notices, this amount is negligible.[29]

Reprioritisation of labour

As noted in our draft determination, we accept that ActewAGL's reprioritisation of labour from other projects to vegetation management was an action that did reduce the magnitude of ActewAGL's proposed pass through event. We consider that this represented an efficient course of action and resulted in a reduction in the magnitude of the proposed cost pass through event. However, we are still of the view that ActewAGL should have undertaken further prudent operational risk management when it became aware that vegetation growth rates were increasing.

Introduction of new technology

The introduction of new technology was not rolled out until the end of the 2012–13 year. Although we accept that this is an improvement in ActewAGL's vegetation management practices, our view is that the timing of the roll out is such that it would have had a minimal impact on the overall cost of the proposed pass through event.

Overall assessment of ActewAGL's mitigation actions

As noted above, we are of the view that the actions taken by ActewAGL would have had a minimal impact on reducing the costs of the pass through event. It is not apparent, based upon the information ActewAGL has provided in support of its application that it had a strategy to effectively monitor, anticipate and respond to changes in vegetation growth, such that additional costs from changes in growth rates might be prevented or mitigated. ActewAGL does not appear to have responded to evidence of significant vegetation growth in a timely manner such that it could take operational risk management initiatives in mitigation.

We consider that prudent operational risk management could have prevented or mitigated the effect of the proposed pass through event. In reaching this view we have considered that:

- ActewAGL's vegetation management strategy does not include sufficient actions to recognise, prevent, or mitigate the effect of vegetation encroachment
- ActewAGL has not demonstrated it gave consideration to whether its contractual arrangements were appropriate in the circumstances. We consider that the use of hourly rate contracts hindered ActewAGL's ability to prevent or mitigate the effect of vegetation encroachment
- ActewAGL's vegetation management expenditure was increasing more rapidly than the increase in vegetation growth due to high contractor costs and inefficient vegetation management practices and yet ActewAGL does not appear to have taken timely action to investigate or adopt operational changes to address these issues
- ActewAGL's adoption of LiDAR technology may have resulted in increased costs but in any event occurred too late to have an impact in relation to this event.

These issues are discussed further in sections 6.2.1-6.2.4 below.

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[29] ActewAGL, *Vegetation management cost pass through,* November 2013, pp. 20–23.

6.2.1 ActewAGL's vegetation management strategy

Our draft determination set out concerns surrounding ActewAGL's vegetation management strategy. The draft determination stated that ActewAGL's vegetation management strategy appears 'reactive' and that a pre-emptive strategy would have been more effective at mitigating the proposed pass through event.

In our view, ActewAGL has provided no evidence that demonstrates that its vegetation management strategy allows ActewAGL to anticipate increases in vegetation growth rates and take pre-emptive action to prevent future increased vegetation encroachment. The following sections look at the time taken to identify the vegetation growth and the actions taken by ActewAGL to mitigate the pass through event.

Time taken to identify the increased vegetation growth

The ACT experienced above average rainfall in 2010–11 and 2011–12 but the vegetation clearance work, the subject of ActewAGL's cost pass through application, did not take place until 2012–13. There is no evidence to suggest that ActewAGL adjusted its vegetation management strategy as the increase in vegetation growth occurred.

ActewAGL stated that increased vegetation growth was not apparent until the preparation for the 2012–13 bushfire season. However, information submitted by ActewAGL indicates that vegetation growth was already increasing significantly in 2011–12. For example:

- the number of vegetation clearance notices issued by ActewAGL rose from 4676 in 2010–11 to 8722 in 2011–12[30]
- ActewAGL’s vegetation clearance contractor costs increased significantly from 2010–11 to 2011–12. Details of this are shown in confidential appendix B to the AER's draft determination
- the initial saturating rainfall event occurred over a five month period between October 2010 and February 2011.[31] That is, there was sustained, significant rainfall over a number of warm months, when vegetation growth rates would be expected to climb.

We sought information from ActewAGL on the volumes of work undertaken over the period, as this would aid in identifying when the significant increase in vegetation growth was apparent. ActewAGL indicated that it was not able to provide the volumes of work undertaken. In our view, this evidences that vegetation growth and costs were not being monitored in a prudent fashion.

Given that ActewAGL patrols its network annually and had a significant and observable increase in first notices issued across the 2011–12 period, it is apparent that ActewAGL was, or should have been aware of the regrowth event by around late 2011 or early 2012. In our view this would have given ActewAGL ample time to adopt a considered and managed response to the regrowth event before the 2012–13 bushfire season.

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30 ActewAGL, *Vegetation management cost pass through: additional information – attachment A,* December 2013.

31 This is evidenced in data ActewAGL provided to the AER in November 2013 in support of its cost pass through application. ActewAGL note in their cost pass through application that the data is sourced from the only ACT weather station (the Canberra Airport), in the Australian Reference Climate Station Network (ARCSN) - see ActewAGL, *Vegetation management cost pass through,* November 2013, p. 7.

To illustrate, if we consider the typical requirements of ISSC 3 (an industry vegetation standard applied widely across NSW) no action would be required for at least 3 months unless the regrowth exceeded more than 50% of the safety clearance space, a situation that would require regrowth substantially exceeding both the regrowth allowance (typically in the order of 1m or 2m) as well as 50% of the safety clearance (typically in the order about 1m for bare low voltage and greater for high voltage). While Australian natives can respond well to favourable conditions, as illustrated by consideration of ISSC 3 requirements, the extent of regrowth necessary between October 2010 and late 2011 or early 2012 that would require a more rapid response seems unlikely. Hence, ActewAGL should have had several months at least to be able to respond by adjusting its vegetation management strategy in a considered and managed way rather than seeing this as requiring some kind of urgent or emergency response.

The initial rain event occurred between October 2010 and February 2011. If we allow some time for the vegetation regrowth to become apparent, ActewAGL should have been aware of this by early 2012 at the latest. This would have given ActewAGL several months to plan the work that was undertaken in 2012–13. This was not an emergency situation.

Actions taken by ActewAGL to mitigate the pass through event

ActewAGL refers to the Jacobs report in noting that no DNSP in Australia monitors rainfall and adjusts pruning practices accordingly. ActewAGL submitted that its ability to pre-emptively adjust pruning practices is limited because it cannot control the extent to which vegetation is trimmed in urban areas, and the Code of Practice requires that vegetation be cleared to achieve a three year cut cycle. The Jacobs report set out a number of elements in forming a view that ActewAGL is pro-active in its approach to vegetation management.[32]

We agree that the ability of a DNSP to be pre-emptive does not necessarily involve monitoring the level of rainfall. Rainfall is just one factor that leads to increased vegetation growth in any case. There are also other clearer indicators, such as direct observations like those mentioned above about increases in clearance notices, volumes of clearance undertaken and operational costs. ActewAGL has provided no evidence of a response to indicators of increasing vegetation growth in its early stages, and this is critical to our decision.

Pages 5-6 of the first Jacobs report listed a number of actions that Jacobs contends provide evidence of a pro-active approach to vegetation management. We are of the view that these actions, are not indicative of a pro-active vegetation management strategy.[33] There were a range of possible responses ActewAGL could have prudently had to the vegetation growth including:

- reassessing the vegetation management strategy to target higher risk areas,
- altering standards or cutting practices (as earlier noted),
- reprioritising work to reduce costs associated with low priority/low risk areas,

32 ActewAGL '*Vegetation management cost pass through application: ActewAGL response to the AER draft determination*', June 2014, pp. 15–17.

33 With the exception of LiDAR which is an emerging technology.

- adopting a different contracting approach such as an outcomes based or performance based contract that was specifically targeted to address the regrowth issue,
- undertaking a review of its costs and cost drivers to ascertain and address the cause(s) of the growing unit rate trend,
- undertaking a management review to assess if the overall response to the regrowth event was being managed efficiently and effectively.

We have evidence that these responses have been used by other DNSPs when faced with increasing vegetation growth and rapidly increasing costs. For example:

- when faced with rapidly increasing vegetation management costs following the break in the drought in mid 2010, South Australian Power Networks (SAPN) undertook the following actions to reduce costs:
    - ceasing pre-summer patrols after shifting to an annual clearance cycle;
    - obtaining independent advice on the unit costs of undertaking both vegetation inspection and clearance work; and
    - deferring components of the non bushfire risk area vegetation inspection and clearance to later regulatory years where that is permitted under the relevant South Australian legislation.[34]
- following the creation of Networks NSW, a strategic review of the vegetation management practices of each business (Ausgrid, Endeavour Energy, Essential Energy) was carried out. The review considered and identified areas of refinement for a range of issues relevant to a vegetation management strategy including vegetation clearance standards, close approach tree trimming, aerial patrol & analysis, contract management models, and other considerations such as transition plans, business processes, public education & overhead allocation.[35]
- this example is discussed in confidential appendix C.

ActewAGL has provided no evidence to the AER that it undertook any of the strategic responses listed above. In substantive terms, ActewAGL continued its standard practices in the face of increasing cutting volumes, growing costs, and increasing unit cost trends that should have been apparent in management key performance indicators.[36]

6.2.2 Approach to vegetation clearance contracting arrangements

In our draft determination we considered and evaluated the efficiency of hourly rate approaches and unit rate approaches in vegetation clearance contracting arrangements. We concluded that the hourly rate contracting arrangements ActewAGL has in place to undertake vegetation clearance work are not efficient and have hindered ActewAGL's ability to prevent or mitigate the effect of the increased

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[34] AER, *SA Power Networks cost pass through application for vegetation management costs arising from an unexpected increase in vegetation growth rates*, July 2013, p.14.

[35] Essential Energy, Supporting information to the 2014-19 regulatory proposal - Item 6.2 Vegetation Management Review Findings Appendix, p. 1.

[36] AER Technical Advisory Group, Targeted technical advice, 30 June 2014 p.4.

vegetation growth.[37] The following sections address two issues raised in submissions, namely that the use of hourly rate contracts is appropriate for emergency response work, and that unit rate contracting is superior to hourly rate contracting.

Use of hourly rate contracts for emergency response work

ActewAGL's response to our draft determination did not accept the AER's view of its contracting arrangements and submitted that ActewAGL's contracting arrangements facilitated ActewAGL's efficient response to the increased vegetation growth.[38] ActewAGL relies upon the expert report attached to its submission which concludes that the use of hourly rate contracts for unprogrammed, unexpected or emergency response work is the most common practice across the Australian electricity industry and constitutes what a prudent and efficient operator would have done in similar circumstances to ActewAGL.[39]

We do not accept Jacobs' characterisation of the vegetation clearance work undertaken by ActewAGL as unprogrammed, unexpected or emergency response work. Rather, we consider that the clearance work undertaken by ActewAGL should have been carried out in a planned and controlled manner as part of its business as usual approach to vegetation management.

More importantly, as discussed in section 6.2.1, it is apparent that ActewAGL was, or should have been aware of the regrowth event by around late 2011 or early 2012. In our view this would have given ActewAGL ample time to consider and review its contracting strategy, including the use of hourly rate contracts for the vegetation clearance work it was undertaking.

Hourly rate compared to unit rate contracting

ActewAGL submits that the Aurora expert report referred to in the AER's draft determination does not support the proposition that unit rate contracting is superior, or generally more efficient than hourly rate contracting. Nor in ActewAGL's view does the Aurora expert report support any conclusion as to the relative efficiency of hourly rate and unit contracting in ActewAGL's particular circumstances.[40] Further, ActewAGL submitted that the analysis undertaken by TAG in its report failed to adequately take into account differences between different networks. In its 2 July submission, ActewAGL made a similar submission in relation to the Aurora Energy expert report. Aurora Energy also expressed concern the AER had taken the Aurora expert report out of context and that any reliance on the report could not be extended to the draft determination without understanding the particular circumstances of ActewAGL.[41]

The Australian Competition Tribunal (Tribunal) decision in the *Application by United Energy Distribution Pty Limited [2012]* ACompT 1 provides a note of caution about considering the analysis undertaken utilising benchmarking techniques without properly considering the circumstances of the

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[37] AER, Draft determination, ActewAGL distribution cost pass through application – vegetation management costs for the *2012–13 regulatory year*, June 2014, pp. 20-21.

[38] ActewAGL '*Vegetation management cost pass through application: ActewAGL response to the AER draft determination*', June 2014, p. 17.

[39] Attachment 1 to ActewAGL '*Vegetation management cost pass through application: ActewAGL response to the AER draft determination*', June 2014 - Report by Cliff Jones of Jacobs Group (Australia) Pty Limited dated 17 June 2014.

[40] ActewAGL '*Vegetation management cost pass through application: ActewAGL response to the AER draft determination*', June 2014, pp. 21-24.

[41] Aurora Energy, *Submission on the AER's draft determination on ActewAGL's cost pass through application*, 20 June 2014, p. 1.

business. [42] We recognise the need to be cautious before applying the analysis of one business against that of another. We also recognise that DNSPs use various contracting models, often including a combination of more than one model. The evidence we have considered in assessing ActewAGL's pass through, however, demonstrates that hourly rate contracting models are often associated with higher costs:

- as mentioned in the draft determination, the Aurora expert report provides evidence that hourly rate contracting arrangements are potentially more inefficient that other forms of contracting. Under this type of contracting arrangement, the risk associated with low productivity lies with the DNSP, and hence consumers, as the contractor has little incentive to drive increased productivity.
- similar evidence was provided in a recent submission from Essential Energy in support of its regulatory proposal for the 2014-19 regulatory control period. That submission supports the view that hourly rate contracting arrangements are potentially more inefficient than other forms of contracting. Following a strategic review of its vegetation management practices, Essential Energy also identified issues with its contracting arrangements:

> 'Essential Energy use an hourly rate model that relies on internal vegetation management staff reviewing defects, either from the ground or during the PSBI process and then creating work packets for contractors to return vegetation to required clearances. The hourly rate model creates little or no incentive for contractors to deploy resources efficiently as all of their costs are covered. In fact the reverse is the case with an hourly rate model creating an incentive to over service the business.' [43]

The TAG's second report supports the conclusion we reached in our draft determination. In the second report the TAG identified that since 2008–09 there has been a marked upward trend in ActewAGL's total vegetation management cost with no evidence of any prudent action taken by the business to arrest the impact of this trend on total costs.[44]

ActewAGL submitted that, similar to the Aurora expert report, the AER cannot rely upon statements in Essential Energy submission on hourly rate contracting to form a view that unit rate contracting is more efficient when making its final determination on their cost pass through application.[45] ActewAGL also submitted that the AER failed to take into account the advantages of hourly rate contracts as set out in the Aurora expert report.

We agree that hourly rate contracting arrangements have their advantages, as part of a well thought out vegetation management strategy. As mentioned in the first Jacobs report, DNSPs generally use a mix of contracting strategies, which may include hourly rate contracting.[46] However, Jacobs also recognises that hourly rate contracting arrangements are generally used for emergency work, rather than a 'business as usual' approach to vegetation management.

In explaining the advantages of its hourly rate arrangements, ActewAGL submitted that the hourly rate contracts allow ActewAGL to effectively address the urgent operational imperative to clear vegetation

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42 ActewAGL, '*Vegetation management cost pass through application: ActewAGL response to the AER draft determination*', June 2014, p 26.

43 Essential Energy, *Supporting information to the 2014-19 regulatory proposal - Item 6.2 Vegetation Management Review Findings Appendix*, p. 13.

44 AER Technical Advisory Group, *Targeted technical advice,* 30 June 2014, pp. 3-4.

45 ActewAGL, *Response to Essential Energy Documents provided by the AER on 27 June 2014*, July 2014, pp. 11-12.

46 Attachment 1 to ActewAGL '*Vegetation management cost pass through application: ActewAGL response to the AER draft determination*', June 2014 - Report by Cliff Jones of Jacobs Group (Australia) Pty Limited dated 17 June 2014, p 3.

encroachment resulting from the increased vegetation growth.[47] Given that we do not characterise the majority of the vegetation clearance work conducted by ActewAGL as emergency response, we consider that the benefits claimed by ActewAGL do not overcome the concerns regarding hourly rate contracts raised by the Aurora expert report and ActewAGL. Therefore, in our view, ActewAGL has not adequately explained why the experiences of Aurora and Essential in relation to hourly rate contracts do not apply to it.

ActewAGL also submitted that our draft determination placed insufficient weight on its controls in place to manage risk from issues identified in the Aurora expert report.[48] We consider that despite the controls ActewAGL has in place, it has not shown that its contracting approach has resulted in the most efficient outcome possible. Work estimates calculated by ActewAGL are based on costs that are incurred using an hourly rate contracting approach and therefore include inefficiencies inherent in this type of contracting arrangement. Even though these controls may assist in confirming the performance of specific contractors, they do not suggest that the most efficient approach to vegetation cutting is being utilised.

ActewAGL further set out that the AER failed to have regard to the disadvantages of unit rate contracting identified and discussed in the Aurora expert report.[49] The AER considers that issues such as incentives for contractors to take short-cuts and to trim rather than remove large trees are able to be addressed through auditing of work undertaken by contractors. The ability for a DNSP to seek cost variations, and the level of engagement with stakeholders can also be dealt with when developing an appropriate unit rate approach and further through the inclusion of specific contract clauses.

Given that ActewAGL has provided no evidence that it considered its use of hourly rate contracts as part of its overall vegetation management strategy, we remain of the view that ActewAGL's contracting arrangements have hindered its ability to mitigate the cost of the pass through event. ActewAGL has not demonstrated, in any event, that it took action at the appropriate time to review its practices, including contracting arrangements, as a prudent operator would be expected to do.

6.2.3 Increasing vegetation management costs

In our draft determination, we set out that ActewAGL's vegetation management costs are increasing more rapidly than the increase in rate of vegetation growth. We were of the view that the increases in ActewAGL's vegetation management expenditure are the result of inefficiencies in its vegetation management practices and not prudent operational risk management.[50] We maintain this position in the final determination.

As part of our draft determination position, we considered figures provided in the TAG report showing an upward trend in vegetation management costs. We also note that contractor costs are a major

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47 ActewAGL, *Response to Essential Energy Documents provided by the AER on 27 June 2014*, July 2014, pp. 17-18.

48 ActewAGL '*Vegetation management cost pass through application: ActewAGL response to the AER draft determination*', June 2014, pp. 21-22.

49 ActewAGL '*Vegetation management cost pass through application: ActewAGL response to the AER draft determination*', June 2014, pp. 23-23.

50 ActewAGL, *Vegetation management cost pass through,* November 2013, pp. 20–21.

source of this increase. ActewAGL submitted that the TAG report is unreliable and does not provide probative evidence for the AER's conclusions.[51]

Information submitted by ActewAGL in its response to the AER's second information request provides a breakdown of historic vegetation management costs. This breakdown clearly shows contractor costs being a major contributing factor to the increased vegetation management costs over time.[52] This increase is shown in Figure 6.1 of the AER's draft determination.[53]

ActewAGL submitted that a new Code of Practice came into effect in September 2009 and resulted in the step up in costs shown in Figure 6.1 of the AER's draft determination. The Code of Practice between ActewAGL and the ACT Government Conservatory of Flora and Fauna defines vegetation management responsibilities for unleased Territory land, the land for which ActewAGL has responsibility to clear vegetation. ActewAGL noted that no conclusion regarding ActewAGL's efficiency can be gleaned from the AER's analysis unless this step up in costs is taken into account.[54]

ActewAGL relies on a comparison of the change in costs since the Code of Practice came into effect and the number of first notices issued as a measure of the volume of work undertaken. ActewAGL's analysis shows that both total costs and contractor costs increased by less than the number of first notices issues indexed to 100 in 2009–10. From 2009–10 to 2012–13 first notices increased by 113 per cent, supplier costs increased by 81 per cent, and total costs increased by 62 per cent. ActewAGL submitted that this demonstrates increases in the efficiency of its vegetation management program over time.[55]

We are of the view that ActewAGL's analysis cannot reliably demonstrate that its vegetation management practices have become more efficient over time. While the Code of Practice requirements may have contributed to increases in vegetation management costs, ActewAGL has not provided the volume of vegetation clearance work undertaken to support this assumption. In fact, ActewAGL's submission indicated that it does not have any historical clearance information.[56] Without information showing the volume of vegetation clearance work undertaken, it is not possible to conclude that ActewAGL's cost increases have been incurred due to increases in the volume of work undertaken.

While the Code of Practice may have resulted in an increased level of costs between the 2008–09 and 2009–10 regulatory years, it does not explain the continuous increase in costs from 2009–10

[51] ActewAGL '*Vegetation management cost pass through application: ActewAGL response to the AER draft determination*', June 2014, p. 29.

[52] ActewAGL, *Vegetation management cost pass through: response to second additional information request,* February 2014, p. 9.

[53] AER, *Draft determination, ActewAGL distribution cost pass through application – vegetation management costs for the 2012–13 regulatory year, Confidential appendix B,* June 2014, p.2.

[54] ActewAGL '*Vegetation management cost pass through application: ActewAGL response to the AER draft determination*', June 2014, p. 30.

[55] ActewAGL '*Vegetation management cost pass through application: ActewAGL response to the AER draft determination*', June 2014, pp. 30–31.

[56] ActewAGL, *Vegetation management cost pass through: response to second additional information request,* February 2014, pp. 6–8; ActewAGL '*Vegetation management cost pass through application: ActewAGL response to the AER draft determination*', June 2014, p. 30. The AER also requested this information in its second information request, however ActewAGL was not able to provide this information.

onwards. Figure 6.1 of the AER's draft determination shows that contractor cutting costs continue to increase steeply well after the introduction of the Code of Practice requirements.[57]

6.2.4 Adoption of LiDAR technology

In our draft determination, we set out that ActewAGL's adoption of LiDAR technology resulted in increased costs rather than reducing the magnitude of the proposed cost pass through event. We considered that the decision to use LiDAR would have resulted in the identification of vegetation encroachment that was not related to the proposed pass through event.

In its submission on our draft determination, ActewAGL submitted that LiDAR technology did not identify any vegetation inspection backlog. ActewAGL submitted that higher levels of vegetation growth resulted in encroachment ahead of when assets were due to be inspected. ActewAGL noted that its decision to use LiDAR proved to be prudent as approximately 526 urgent clearance encroachments were identified.[58] In its 2 July submission, ActewAGL submitted that 'in our experience ground crews identify the same amount of vegetation to be cleared as LiDAR technology'.

This statement from ActewAGL is in contrast to the experience of other businesses, both in Australia and abroad, whose trials have found that higher numbers of defects are typically found by LiDAR than by traditional forms of inspection. Networks NSW, for example, noted that, if it were to go ahead with LiDAR inspections, there is a risk that the number of defects identified by this approach would be higher than historic levels, with associated resourcing and rectification cost implications.[59] Ergon Energy and the transmission line operator in Ontario, Canada, have had similar experiences.[60]

ActewAGL submitted that the experience of Ausgrid and Endeavour Energy is necessarily different to that of ActewAGL. ActewAGL sets out that, in line with the Tribunal's decision in the *Application by United Energy Distribution Pty Limited [2012]* ACompT 1, the AER should not seek to apply conclusions made by other DNSPs to ActewAGL's circumstances.[61] We recognise the need to be cautious when comparing the experience of other businesses with that of ActewAGL. However the NSW DNSPs, as well as the transmission line operator in Ontario, Canada, are utilising the same technology as ActewAGL and for the same purpose. ActewAGL has not submitted any evidence to suggest that the experience of these businesses is distinct from that of its own use of LiDAR.

LiDAR is an emerging technology which is increasingly being used by network businesses for vegetation management purposes. Although we are not necessarily opposed to the use of LiDAR technology under normal circumstances, based on the experiences of other businesses we remain concerned that the level of vegetation encroachment identified by ActewAGL's use of LiDAR is not necessarily the result of the proposed pass through event. As such, we consider that the use of LiDAR may not have mitigated the effect of the proposed cost pass through event.

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57 AER, *Draft determination, ActewAGL distribution cost pass through application – vegetation management costs for the 2012–13 regulatory year, Confidential appendix B,* June 2014, p.2.

58 ActewAGL '*Vegetation management cost pass through application: ActewAGL response to the AER draft determination*', June 2014, p. 33.

59 Networks NSW, *Executive leadership group meeting, item no. 7.3,* 20 June 2013, p. 4.

60 AER, *Draft determination, ActewAGL distribution cost pass through application – vegetation management costs for the 2012–13 regulatory year,* June 2014, p. 22.

61 ActewAGL, *Response to Essential Energy Documents provided by the AER on 27 June 2014*, July 2014, p. 6.

6.3 Change in cost must be material

ActewAGL submitted that the costs amount to 1.10% of the smoothed revenue requirement and 1.07 per cent of the annual revenue requirement. We agree with ActewAGL's calculation. If ActewAGL had demonstrated that prudent operational risk management could not have prevented or mitigated the effect of the event, then we would agree that this criteria in the general nominated event definition had been notionally met.[62] This is further discussed in our draft determination.[63]

6.4 The change in costs is likely to significantly affect ActewAGL's ability to achieve the operating expenditure and/or capital expenditure objectives

The Australian Competition Tribunal (Tribunal) amended the definition of Energy Australia's general nominated pass through event by removing the requirement that the proposed pass through event 'is likely to significantly affect the DNSP's ability to achieve the operating expenditure objectives and/or the capital expenditure objectives…'.[64] Given this, we consider that it is appropriate to take the same position with regard to ActewAGL's cost pass through application. We will therefore not apply this limb of the general nominated pass through event definition. The reasons for this approach are set out in the AER's draft determination.[65]

6.5 Whether the event falls within any other cost pass through definition

ActewAGL's proposed cost pass through event does not fall into any other pass through event definition set out in the NER or any event nominated in ActewAGL's distribution determination. Therefore the AER considers that this criteria is satisfied.

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62 This is on the basis that the claimed costs submitted by ActewAGL are accepted as being prudent and efficient. This is separately considered below.

63 AER, *Draft determination, ActewAGL distribution cost pass through application – vegetation management costs for the 2012–13 regulatory year,* June 2014, p. 23.

64 While the Tribunal cannot make orders by consent it did consider the material the parties put before it and was satisfied as to the existence of reviewable error, and the appropriate relief to grant – see paragraph 262 of *Application by EnergyAustralia and Others* [2009] ACompT8.

65 AER, *Draft determination, ActewAGL distribution cost pass through application – vegetation management costs for the 2012–13 regulatory year,* June 2014, p. 23.

7 Other issues

7.1 Aurora's expert report

In ActewAGL's response to the draft determination ActewAGL submits that the AER failed to provide ActewAGL with access to a complete, unredacted copy of the Aurora expert report. ActewAGL submits it is not open to the AER to limit the disclosure of an expert report upon which it seeks to rely.[66]

We consider that we have disclosed the necessary substance of the Aurora expert report to ActewAGL for the purposes of according ActewAGL natural justice. Prior to release of the report to ActewAGL, both Aurora and its expert were concerned to keep the contents of the report completely confidential.

In considering the redactions to the report we considered the requirements of s. 28Y(c) of the NEL. In particular, we weighed up the need to afford ActewAGL natural justice against the interests of Aurora and their expert in keeping the report confidential. The redactions made to the expert report relate to personal details of contractors, comments of staff and commercially sensitive cost information. We consider that the redacted copy of the Aurora expert report is sufficient to allow ActewAGL to respond to the issues raised by the AER.

7.2 Other information

7.2.1 TAG

The AER's TAG provided advice that was used in our consideration of ActewAGL's application. As an internal group of experts, the TAG are able to provide the AER with insight and advice particularly in relation to operating and management practices in the industry.

TAG provided initial advice on ActewAGL's approach to vegetation management expenditure over the period from 2004-2013. The TAG's conclusion was ActewAGL vegetation management strategy may be inefficient. Further, the TAG indicated that it could not conclude that ActewAGL's contracting practices are efficient.

Following receipt of further submissions from ActewAGL in response to the draft determination, the AER sought further advice from the TAG on ActewAGL's submission including the Jacobs report. The second TAG report is attached as confidential appendix A. A redacted version of the report is at appendix B.

The second TAG report was received by the AER on 30 June 2014. It considers and addresses the further submissions raised by ActewAGL. However, the conclusion in the second report is unchanged from the initial report. That is, ActewAGL has not provided evidence that it took the type of prudent operational risk management, in monitoring and responding to vegetation growth, that would be expected in the normal operations of business to prevent or mitigate the effect of a significant vegetation growth event.

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[66] Aurora Energy, *Submission on the AER's draft determination on ActewAGL's cost pass through application*, 20 June 2014, p. 14.

While the report was received late in this process, we note that it supports the AER's conclusions.

7.2.2 Essential Energy documents

As noted in section 3.5 above, the AER provided ActewAGL with two Essential Energy documents and invited comments on these documents. In its submission on these documents ActewAGL stated that the AER, by not informing ActewAGL of the particular matters in the documents which it intended to rely upon and only giving ActewAGL three business days to comment, had failed to accord procedural fairness.[67]

We consider that by providing ActewAGL with the Essential Energy documents we have given ActewAGL a reasonable opportunity to make submissions and put any additional information before the AER for consideration. ActewAGL made specific responses to the AER on 2 July 2014 in respect of these documents and these responses have been taken into consideration.

The Essential Energy documents illustrate the potential response of a business to vegetation management. It is our view that prudent operational risk management requires consideration of appropriate contracting arrangements, among other things, in response to a vegetation growth event. This issue had been identified and discussed in the draft determination, when reference was made to the example of another business, Aurora.

ActewAGL maintains that the specific actions of specific businesses are not relevant to ActewAGL's pass through application. While we recognise that there may be different responses from different businesses to the environments in which they operate, documents from Aurora and Essential Energy provide examples that indicate actions how costs can be prevented or mitigated in connection with vegetation growth.

7.2.3 Relevance to our conclusion

While we consider the information in the second TAG report and the Essential Energy documents support our conclusion, we would have reached the same decision without the benefit of this information.

To establish the grounds for a pass through event, ActewAGL carries the onus of establishing that there was an event falling outside of the normal operations of business such that prudent operational risk management could not have prevented of mitigated the effect of the event.

ActewAGL has not demonstrated that it was appropriately monitoring changes in vegetation growth to identify the event in a timely and prudent manner. This necessarily affected the ability of ActewAGL to respond to the event through prudent operational risk management. ActewAGL has failed to demonstrate that it investigated or applied risk management measures that could have prevented or mitigated the effect of the event. ActewAGL has not demonstrated that it responded to the increase in vegetation growth when we would have expected, on the evidence provided by ActewAGL, that the event would have come to its attention. ActewAGL continued to manage vegetation growth in the usual manner that it had managed vegetation clearance during the preceding years of low vegetation growth. It is our view that ActewAGL has not demonstrated that it took any material steps, during the

[67] ActewAGL, *Response to Essential Energy Documents provided by the AER on 27 June 2014*, July 2014, p. 3.

period when there were indicators of significant vegetation growth, to prevent or mitigate the effects of this event.