The McKell Institute & ETU NSW

Submission to the AER:

Draft determination on Evoenergy: Regulatory period 2019-2024

January 2019.

Contents

Overview

This submission is in response to the Australian Energy Regulator's (AER) *Draft Decision: Evoenergy Distribution Determination 2019-2024.*

The McKell Institute is a public policy institute dedicated to engaging in key public policy debates. It has authored this submission in collaboration with the New South Wales branch of the Electrical Trades Union (hereafter, ETU NSW).

This submission puts forward further areas for consideration before the AER it reaches its final decision later in 2019.

The McKell Institute and ETU NSW accept the AER's role in regulating distribution networks and driving efficiency. It is important that customers across the National Energy Market have access to reliable, safe networks that are as affordable as possible. The AER's role is vital in achieving this fundamental goal.

However, the AER's determinations at times appear to not be entirely cognisant of the on-the-ground experience of the workers of distribution networks – particularly those on the front line, who occasionally are forced to work with dated infrastructure.

This submission notes, in particular, the risks associated with the AERs language around driving efficiencies through a reduction in workforces. In several incidences, the AER offers firm support for DNSP's decisions to reduce their workforces, without enough evidence that such measures provide the efficiency dividends expected.

While it is important to maintain an efficient workforce, too often, the distribution networks have relied on staff reductions rather than other efficiency measures

In the case of Evoenergy, workforce reductions have not corresponded with a considerable rise in efficiency. Indeed, the AER notes that Evoenergy's performed 4 per cent worse in 2018, despite reducing its workforce by almost a quarter in recent years. This workforce reduction comes at a time where Evoenergy has taken on more responsibilities in terms of vegetation management as a result of legislative changes in the ACT, and during a period of rapid population growth within the ACT which both puts pressure on networks and increases bushfire risks.

As this submission notes, the AER's determination argues for a mere $2.4 million of vegetation management in the ACT – a jurisdiction that sits entirely within a bushfire risk zone that rates the highest possible. The McKell Institute and ETU NSW note that Evoenergy has accepted this sum, but appears to have done so on the basis that any further unexpected

costs associated with vegetation management will be redeemable from customers via 'cost pass throughs'[1].

The $2.4 million p/a allocation is less than the $2.5 million ActewAGL (Evoenergy) spent on vegetation management in 2017-18. It is an inadequate sum given that Evoenergy is responsible for the maintenance of an estimated 35,000 trees that intrude on network infrastructure, before considering other vegetation management costs. Additionally, Evoenergy has already reduced its vegetation management costs by 58 per cent from their peak, and previously relied upon outsourcing vegetation management responsibilities.

The lack of consideration towards vegetation management in the draft determination that is the subject of this submission is not only putting ACT residents at risk of both network disruptions and fire damage, but it also sets an unwelcome precedent for future AER deliberations. It does not mean that Evoenergy will only spend $2.4 million p/a on vegetation. Any unexpected eventualities will have to be managed by Evoenergy. It may mean, however, that consumers end up bearing the brunt of any unexpected costs associated with vegetation management. Additionally, Evoenergy will be discouraged from spending more on vital vegetation management, as running expenditure above and beyond their AER designed OpEx can adversely impact them in future benchmarking exercises by the AER.

Though this submission focuses on the regulatory period facing Evoenergy, it puts forward arguments that are relevant to future determinations of the AER in other jurisdictions.

While the complex nature of the National Energy Market makes comparing every DNSP and its regulatory environment a challenge, The McKell Institute and ETU NSW believe that, through the AERs various determinations, precedents are being set that may apply to future determinations. The AER regulates an extraordinarily complex and multifaceted network. However, it is important that, in the pursuit of efficiency, the AER doesn't foster a regulatory environment that prioritises achieving benchmark efficiency standards over the safety of individual network workers, and the community at large.

[1]https://www.aer.gov.au/system/files/Evoenergy%20vegetation%20management%20pass%20through%20application.pdf

Key Points

- The AERs language around efficiency targets often endorses wholesale reductions in DNSP workforces. The McKell Institute and ETU NSW are concerned that the AER is undervaluing vital expenditure on training and the skilling of the sectors workforce.

- It is the view of the McKell Institute and the ETU NSW that the benchmarking methodology adopted by the AER risks incentivising Evoenergy and other DNSPs to seek OpEx reductions primarily through workforce reductions.

- Such workforce reductions are touted as means to achieving more efficient networks. Evidence published by the AER, however, is mixed. Evoenergy remains less efficient than certain other DNSPs, despite a 24 per cent reduction in its workforce.

- Evoenergy and the AERs documents appear to suggest vegetation management has been inadequately addressed given ACT's high fire risk and changes in legislation. This creates an unnecessary risk environment, potentially placing further strain on an already diminishing Evoenergy workforce.

- The AERs determination that only Evoenergy only utilise $2.4 million to meet its vegetation management responsibilities is inadequate. Evoenergy is responsible for the pruning of over 11,000 trees per year, according to data it submitted during this determination round. Any cost overruns associated with vegetation management will likely be borne by customers via cost pass throughs, which Evoenergy has applied for.

Part 1: Past McKell Institute submission to the AER

In February 2015, the McKell Institute delivered a submission to the AER in response to the Essential Energy Draft Determination of that period. The McKell Institute's 2015 submission, while focused on Essential Energy's draft determination, aimed to put forward some broader arguments for future reference of the AER. In that submission, the McKell Institute explored the price-side of the AERs responsibility, as well as identifying what it believed were certain gaps in risk management and reliability considerations put forward by the AER.

It noted previous language in AER determinations that were incongruous with the roles of other Government agencies, such as the Fair Work Commission, which demonstrated a lack of focus on the conditions workers within the distribution networks faced. The 2015 submission found that:

> "AER appears to have entrusted to itself, with no legislative basis, the power to refute the determinations of the Fair Work Commission. We quote from the Ausgrid Draft Determination:
>
> > "The presence of a legal obligation, by itself, is insufficient to justify us providing opex for a particular item... Enterprise Agreements are one example of this. If a contractual or legal obligation were sufficient to justify the provision of opex, it would curtail the scope for us to undertake efficiency assessments."[i]
>
> The AER here appears to be ignoring the role of the FWC entirely. The FWC is responsible for ensuring that labour is not unfairly remunerated by businesses and that conditions are reasonable"[2].

This new submission does not include parallel findings to those in the 2015 submission. However, as in the previous submission, it does note that the AER does not appear to adequately consider the conditions of the workforce responsible for the day-to-day operations of electricity networks in its determinations. This is evidenced in the draft Evoenergy determination and other documents cited below that appear to both encourage and support measures by the network operators to reduce OpEx through workforce reductions and lower spending on training. In some cases cited below, the AER notes that such measures have not directly created efficiencies. Evoenergy remains one of the least efficient DNSPs despite reducing its workforce by 24 per cent over the recent regulatory period.

As is detailed below, the McKell Institute's 2015 concerns remain to a certain degree.

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[2] McKell Institute, 2015. Submission to the AER: Response to Essential Energy Draft Determination. Page 9

Part 2: A note on benchmarking methodology

The AER benchmarks distribution networks by using multilateral total factor productivity – a method that allows the total factor productivity of different DNSPs to be compared.

The McKell Institute previously criticised certain elements of the benchmarking methodology adopted by the AER. It is clear that the AER has refined its benchmarking methodology over the previous years. However, the benchmarking methodology adopted by the AER still retains elements that cause some concern for those seeking adequate regulatory outcomes, particularly when it comes to the future of the industry's workforce.

Broadly speaking, The McKell Institute and ETU NSW are concerned that the benchmarking methodology does not adequately account for investments or expenditure allocated towards the safety or training of the workforce, or indeed the maintenance of an adequate workforce at all.

As one example, there is no specific reference to the skilling of the future workforce in the industry in OpEx breakdowns in the benchmarking methodology. In its analysis, The McKell Institute and ETU NSW have found no evidence that the AER's benchmarking methodology appropriately considers investments in the current and future workforces of the industry as investments at all. This omission is considerable.

Indeed, many of the efficiencies gained – efficiencies that have been beneficial towards DNSPs in the context of the benchmarking exercise – have come as a result of a reduction in OpEx achieved through a reduction in labour costs.

The McKell Institute and ETU NSW understand the need for DNSPs to maintain efficient workforces. However, in analysing the AER's determinations and language in benchmarking exercises, it is possible to conclude that the AER supports DNSPs seeking efficiencies through workforce reductions beyond other measures. That labour costs, training costs, or the detailed nature of maintenance costs is not adequately tabled in the OpEx costings included in the benchmarking report is of concern.

This approach appears misguided and somewhat myopic. The precedents that are being set by such benchmarking approaches may facilitate a 'race to the bottom', where DNSPs adopt a single minded focus on achieving efficiency dividends that appease the AER benchmarking model rather than focusing on the best interests of their organisation, their workforce, their industry and consumers over the longer term.

The AER, in its efforts to continually improve its benchmarking methodology, should be more cognisant of the nuanced nature of OpEx – in particular, the nature of labour and associated costs – for each DNSP. Expenditure allocated towards training, for example, should be considered an investment rather than a mere expense that the AER is encouraging DNSPs to lower.

Part 3: AER encouragement of workforce reductions

The AER plays a central role in ensuring that DNSPs are operating at optimal efficiency, ensuring networks remain reliable and as affordable as possible for customers. In understanding the complex regulatory environment in which the AER operates, The McKell Institute and ETU NSW accepts the broad objectives of the AER in ironing out unnecessary inefficiencies within the sector.

Of concern, however, is the AER's focus on workforce reductions as a primary means of achieving reduction in OpEx. As this section highlights, the AER often encourages DNSPs to pursue workforce restructuring, even when there is evidence that this has *not* led to efficiency gains.

INTERNAL LABOUR EXPENDITURE		2017-18
CORPORATE OVERHEADS	Executive manager	3,408,606
	Senior manager	1,932,142
	Manager	4,029,367
	Professional	4,459,440
	Semi professional	4,597,041
	Support staff	1,049,680
	Intern, junior staff, apprentice	60,115
NETWORK OVERHEADS	Executive manager	1,166,535
	Senior manager	1,683,637
	Manager	5,299,872
	Professional	7,396,286
	Semi professional	928,626
	Support staff	7,412,952
	Intern, junior staff, apprentice	356,093
TOTAL DIRECT NETWORK LABOUR	Skilled electrical worker	21,314,159
	Skilled non electical worker	-
	Apprentice	502,330
	Unskilled worker	4,143,147

Figure 3.1: Breakdown of Evoenergy labour costs, 2017-18.

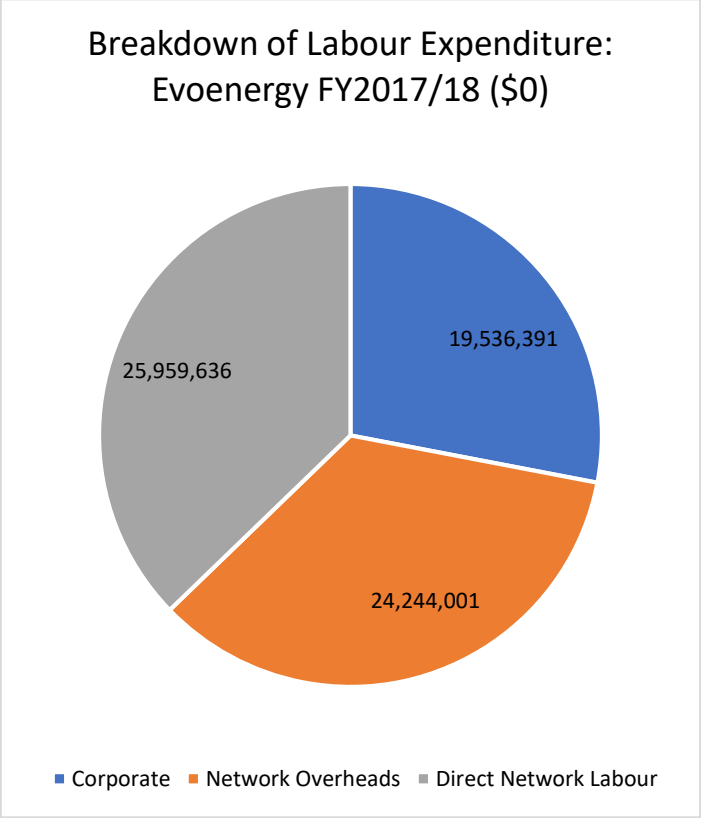

Figure 3.2: Breakdown of Evoenergy labour costs, 2017-18.

Evoenergy has diminished its workforce over recent years to meet AER targets

In its submissions to the AER, Evoenergy has made clear that it has sought to achieve efficiency targets through the reduction in its workforce. As the AER states:

> "Evoenergy reduced its total opex by 45 per cent between 2014–15 and 2015–16. **Over the same period, it has also reduced its permanent Evoenergy distribution determination 2019–24 workforce by 24 per cent**. This significant reduction meant that its opex in 2015–16 and 2016–17 was below the opex forecast in our April 2015 final decision. For 2017–18 and 2018–19, Evoenergy estimates that its opex will be at the same level that we forecast in our April 2015 final decision."[3]

The AER continues:

[3] https://www.aer.gov.au/system/files/AER%20-%20Evoenergy%202019-24%20-%20Draft%20decision%20-%20Attachment%206%20-%20Operating%20expenditure%20-%20September%202018_0.pdf Page 21

"In its regulatory proposal for the 2019–24 regulatory control period, Evoenergy stated that it has achieved its opex savings through, among other measures, shrinking its workforce and **lowering costs associated with staff training**:

- **an extensive restructuring of the workforce including redundancies**
- re-engineering and asset optimisation to reduce the program of works
- savings on vegetation management using new light detection and ranging (LiDAR) technology and improved contractual arrangements
- investment in systems technology to drive smarter operation of the network, including improvements in automation and asset management practices,
- **a reduction in overtime and staff training."**

The AER does not note any consequences of Evoenergy's decision to achieve OpEx reductions through its workforce reduction and lower expenditure on staff training. The McKell Institute and ETU NSW believe that in cases of such explicit reductions in both staff and the training of staff, the AER should determine what impacts these may have on current and future workers employed by the DNSP.

Evidence that Evoenergy staff are already under strain

Evoenergy has significantly reduced its workforce in recent years in order to achieve OpEx reductions. During this determination, Evoenergy tabled that it has reduced its workforce by 24 per cent.

Recent media reporting of a case involving a serious Evoenergy oversight suggests that at least occasional administrative errors are occurring.

In 2017, Evoenergy failed to notify 4 individuals on life support that their power was to be cut. This basic administrative error resulted in the AER fining Evoenergy $20,000. Such an error could have had disastrous consequences. It was also the second time Evoenergy had been fined for failing to provide electricity to a customer on life support[4]. That such mistakes have coincided with the 24 per cent reduction in Evoenergy's workforce is cause for concern. While it is difficult to ascertain the specific drivers of such administrative errors, it is clear that, in order to avoid all future incidents, adequate measures need to be adopted.

[4] https://www.canberratimes.com.au/canberra-news/evoenergy-to-pay-fine-over-power-supply-cuts-to-life-support-customers-20180613-p4zl92.html

The McKell Institute and ETU NSW support the AERs determination that, in the wake of the incident, Evoenergy must 'improve its supply interruptions identification and notification processes', while remaining concerned that the diminishing workforce and growing ACT customer base may pose future risks.

In preparation for this submission, evidence regarding the pressures on local workforces from ETU NSW organisers within the ACT were solicited. This submission notes that many workers within the electrical trade in the ACT, including Evoenergy, are susceptible to repetitive-stress-like injuries and, often, seek retirement at ages earlier than the average across the workforce. The AER should consider in its deliberations the impact its efficiency targets may be having on individuals in such positions.

The AER explicitly encourages significant workforce reductions

Of concern to The McKell Institute and ETU NSW is the language deployed by the AER in regards to cost savings through workforce reductions. In this analysis, The McKell Institute and ETU NSW cannot identify any discussion about the externalities associated with a reduction in staff and staff training. At times, the *loss* of efficiency is caveated by the AER as a necessary by-product of workforce transformations. The same leave is not granted to expenditure that invests in the current and future workforce of the DNSPs under the purview of the AER.

It is worth noting that, while the AER often highlights these major workforce reductions, it offers no discussion about the consequences of these measures, beyond the obvious point that it has reduced OpEx for the DNSPs. The McKell Institute and ETU NSW contend that, in discussions on workforce reductions, the AER must fully consider and table any future ramifications. This may include the impacts of a decline in spending on staff training, the impact of reducing DNSP expenditure on apprentices and trainees, and how such measures may impact the future supply of skills for the industry. The McKell Institute is concerned that such broad reductions in workforce and expenditure directed towards training a future generation of skilled workers in the sector may impact consumers over the long term.

Productivity not immediately the result of workforce reduction

At times, productivity has not necessarily been the immediate by-product of workforce reductions. The AER's benchmarking report finds that Evoenergy, which has reduced its workforce by around a quarter from its peak, was one of few DNSPs to decline in its productivity over the assessed period:

"Evoenergy (–4 per cent) experienced moderate decreases in productivity"[5].

This comes despite Evoenergy's 24 per cent reduction in its workforce and lower expenditure on staff training. Evoenergy's focus on achieving productivity through a reduction in labour costs may have an impact on overall productivity.

The McKell Institute and ETU NSW accept the AER's determination to improve efficiency across distribution networks. But there is, at times, no clear dividend for such reductions beyond an immediate reduction in OpEx that may improve a DNSPs standing within the context of the AERs benchmarking methodology. As mentioned above, expenditure on current and future workforces appear to be seen as reducible OpEx costs more than investments. Even when such cost reductions have not resulted in improved productivity, the AER continues to support such measures. This needs to be nuanced. The McKell Institute believes that the AER has a responsibility in ensuring the DNSP workforce is adequately trained, staffed and future-proofed. The language in the AER's benchmarking reports and determinations, however, has the potential to induce the opposite outcome. Evoenergy has diminished its workforce over recent years to meet AER targets which may have a detrimental impact on its front line workers, current and future.

Workforce reductions comes at a time of profit

ActewAGL and now Evoenergy continue to post considerable profits. In FY2016/17 ActewAGL posted a $174 million profit, compared with a $199 million profit in FY2015/16[6]. This profit coincided with the 24 per cent reduction in ActewAGLs workforce.

Reductions in full-time equivalent workforce may result in an increase in the use of external workforces

The pressures placed upon Evoenergy and other DNSPs to minimise their workforce may result in an increased reliant on external workforces, employed on contractual bases.

There are many legitimate and necessary reasons for contractual work for all organisations. An over-reliance on outsourcing work to third party contractors, however, is undesirable – particularly in an industry reliant on highly skilled, specialised and knowledgeable workers.

[5]https://www.aer.gov.au/system/files/AER%202018%20distribution%20network%20service%20provider%20benchmarking%20report%20_0.pdf
[6] https://www.actewagl.com.au/about-us/publications.aspx

The following section notes that Evoenergy deployed contractual labour to meet many of their obligations when it came to vegetation management.

The McKell Institute and ETU NSW are concerned that the AER determination does not adequately consider the ways in which its language may incentivise Evoenergy (and other DNSPs) to engage use external workforces to meet essential tasks. Encouraging a reduction in payroll can lead to a hollowing out of the skills base within an organisation. This is a double edged sword, in that it impacts the Evoenergy's capacity while running the risk of coercing certain skilled workers into contractual arrangements instead of more secure full-time, permanent employment.

In the long term, incentivising an uptick in contractual labour may lead to a de-skilling of the sector's workforce, and make careers in the electrical trades less desirable for certain individuals. It is also probable that an over-reliance on expensive contractual labour will lead to price increased for consumers, potentially through cost pass throughs.

In reaching its determinations, the AER must be cognisant of the long-term impact of incentivising workforce reductions. The McKell Institute and ETU NSW are not satisfied that this has been considered to the extent required in the current Evoenergy draft determination, nor in other determinations examined for the purpose of this submission.

Part 4: Maintenance of ageing infrastructure needs higher priority

2017/18

	Number	Number Inspected / Maintained	% Inspected / Maintained	Avg. Age of Assets
SERVICE LINES	200,465	15,961	7.96	33 years
POLES	52,515	13,557	25.82	29 years

Evoenergy maintains over 200,000 service lines and more than 50,000 poles. The average age of the service lines is 33 years, with poles averaging 29 years in age. While around a quarter of poles are inspected or receive some kind of maintenance each year, just eight per cent of service lines are, according to Evoenergy documents put forward for the 2019-2024 determination. At this rate, it would take over 12 years before all existing service lines receive some kind of inspection or maintenance.

The AER appears to accept that fact that lower ongoing maintenance costs has a direct correlation with higher emergency expenses, or 'reactive maintenance':

> "Emergency services opex has increased but this is potentially driven by Evoenergy's reduction in overall maintenance costs, which may necessitate more reactive maintenance during outages and emergency situations."[7]

The McKell Institute and ETU NSW have concerns over the confluence of an ageing asset base, declining workforce, and AER determinations that actively encourage OpEx reductions through the reduction in maintenance, training and staffing costs. It is likely the reduction in ongoing maintenance costs has a direct correlation with an increase in 'reactive maintenance', as the AER has suggested above.

The McKell Institute and ETU NSW understand that much of the infrastructure in the ACT network is indeed in need of at least some level of maintenance and repair, particular older poles that are constituted of a softer wood than that which is used elsewhere in Australia. In The McKell Institute's conversations with ETU NSW organisers for the purpose of this submission, it was informed that many poles have required bracing, and that front-line workers would, often, prepare poles in any state of degradation to be replaced.

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[7] https://www.aer.gov.au/system/files/AER%20-%20Evoenergy%202019-24%20-%20Draft%20decision%20-%20Attachment%206%20-%20Operating%20expenditure%20-%20September%202018_0.pdf Page 22

Part 5: CapEx

Evoenergy put forward CapEx expectations based around a forecast growth in expenditure relating to ICT security costs and an further expenditure on potentially higher wages.

Evoenergy have argued that they require further capital expense on upgrading ICT systems:

> "[Evoenergy will be] Investing in Information and Communications Technology (ICT) and analytics to transition the business towards the themes of digital transformation, meet industry changes, and maintain reductions in operating expenditure (opex) implemented during the current regulatory period. Evoenergy's proposed expenditure also includes replacement of aged corporate and operational systems to provide a stable technology platform and enable regulatory compliance".[8]

The McKell Institute and ETU NSW take no specific positions on the AERs assessment of forecast capital expenses in relation to ICT upgrades. The McKell Institute and ETU NSW support, generally, capital expenses relating to the modernisation and safety-improvements of the network, particular where clear benefits to consumers and front-line workers can be demonstrated.

The McKell Institute and ETU NSW does have some concerns over the AERs position in regard to labour expenditure on Evoenergy's capital program, as outlined on Page 76 of the AERs determination regarding Evoenergy's CapEx for the forthcoming regulatory period:

> "The argument for higher wages as a driver for an increase in overheads is not well supported. Evoenergy have forecast direct capital labour to decrease by 6 per cent, and total direct labour to decrease by 1 per cent, in 2019–24 compared with the current period. We consider that a decrease in full-time equivalent labour should lead to a decrease in support requirements for the capital program. Furthermore, we would expect that higher wages should, at least in part, be balanced against labour productivity improvements[9]."

Such language suggests the AER are incentivising Evoenergy to further lower the costs of full-time equivalent labour.

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[8] https://www.aer.gov.au/system/files/Evoenergy-Attachment%205%20Capital%20expenditure-January%202018_public.pdf Page 2

[9] https://www.aer.gov.au/system/files/AER%20-%20Evoenergy%202019-24%20-%20Draft%20decision%20-%20Attachment%205%20-%20%20Capital%20expenditure%20-%20September%202018_0.pdf Page 76

By denying Evoenergy the room to cater for a potential growth in labour costs, the AER may be incentivising Evoenergy to put a hand brake on wage rises for its frontline staff. Compared to many industries, highly skilled workers within the electrical trade are well remunerated. But stagnant wage growth more broadly across the economy has caused economic pressures for many individuals in all sectors.

The McKell Institute and ETU NSW are concerned that the limitations placed upon the Evoenergy may exacerbate this trend.

Part 6: Vegetation management needs further consideration

It is the McKell Institute and ETU NSW's assessment that the $2.4 million per annum allocated towards vegetation management is inadequate for Evoenergy to meet the demands of best practice vegetation management. Recent legislative changes in the ACT now require much of the responsibility of vegetation management to be owned by Evoenergy itself. Despite this, the AER has determined that Evoenergy must reduce its expenditure on vegetation management.

To Evoenergy's credit, they have identified the need to expand their expenditure on vegetation management over the coming regulatory period. In their original submission, Evoenergy were cognisant of the scale of the task in managing vegetation that intrudes on their infrastructure. According to Evoenergy, there are almost 35,000 trees in Zones 1 and 2 in the ACT that require ongoing management. Trees in Zone 1 only require cutting once every three years, while trees in Zone 2 require annual cutting. This means that, annually, Evoenergy are responsible for the cutting and management of 11,500 trees, or 32 trees per calendar day. Were the entirety of the AERs estimated $2.4 million allocated only towards tree cutting, this would correspond with just $208 per tree that requires cutting. This is before factoring in a variety of other vegetation management measures.

Poor maintenance of vegetation can lead to power outages[10]. Of further concern is the bushfire risk associated with inadequate vegetation management, particularly in the ACT. The McKell Institute and ETU NSW do not believe that $2.4 million per annum for all vegetation management costs is a realistic allowance.

[10] https://www.canberratimes.com.au/canberra-news/power-out-in-watson-blame-a-fallen-tree-20181226-p50obn.html

The scale of vegetation management is significant

Zone 1	Number of maintenance spans	10,516
	Average number of trees per maintenance span	3
	Average frequency of cutting cycle	3
	Total Trees Zone 1	31,548
Zone 2	Number of maintenance spans	1,018
	Average number of trees per maintenance span	3
	Average frequency of cutting cycle	1
	Total Trees Zone 2	3054
	Total trees Zone 1 & 2	**34,602**

Figure 6.1: Evoenergy's documents reveal the estimated number of tress requiring annual maintenance. In total, almost 35,000 trees requiring some degree of maintenance are estimated to be under Evoenergy's purview, with around a third of these in total requiring annual trimming.

Approx. Trees Requiring Maintenance Per Year	11534
Total AER Allocation for Vegetation Management	$2,400,000.00
Resources Allocated Per Tree If Vegetation Management Exclusively Allocated Towards Tree Trimming	$ 208.08

Figure 6.2: The AER determination only allows for a total of $208.08 per tree requiring trimming that Evoenergy have identified require maintenance annually. The actual quantum of funding allocated towards each tree would be less due to other vegetation management costs, such as ground clearing.

Past expenditure exceeds that allocated for the 2019-2024 regulatory period.

ZONES	SERVICE SUBCATEGORY	EXPENDITURE ($0's)
		2017-18
Zone 1	Tree trimming (excluding hazard trees)	912,534.930
	Hazard tree cutting	0.000
	Ground clearance	0.000
	Vegetation corridor clearance	0.000
	Inspection	936,790.410
	Audit	0.000
	Contractor liaison expenditure	0.000
	Tree replacement program costs	0.000
	Other vegetation management costs not specified in sheet	0.000
Zone 2	Tree trimming (excluding hazard trees)	243,406.530
	Hazard tree cutting	0.000
	Ground clearance	0.000
	Vegetation corridor clearance	0.000
	Inspection	459,110.850
	Audit	0.000
	Contractor liaison expenditure	0.000
	Tree replacement program costs	0.000
	Other vegetation management costs not specified in sheet	0.000
Total Vegetation Management Costs 2017-18		2,551,842.720

Figure 6.3: Evoenergy detailed breakdown of vegetation management costs in FY2017-2018. The total of $2.55 million does not include any expenditure on hazard tree cutting, ground clearance, corridor clearance or tree replacement. Despite this (and other variables, such as population and network growth) the AER has still determined that Evoenergy will only be expected to spend $2.4 million P/A on vegetation management during the 2019-2024 regulatory period.

The entirety of the ACT is at high-risk of bushfire[11]

ACT is unique in that the entirety of the jurisdiction is at high risk of bushfire. Poor maintenance of electricity network infrastructure can lead to an unnecessary exacerbation of this pre-existing environmental risk. Additionally, this risk is set to be exacerbated as populations increase in the ACT. The ACT experienced the second fastest rate of population growth in the September quarter of 2018[12]. Upward pressure on population in the territory is expected to continue over the regulatory period, which may place extra burdens on infrastructure. Were a change of government to occur at the upcoming federal election, it is likely that the staffing cap on the federal public service, the vast majority of which is based in the ACT, will be lifted. Deloitte Access Economics' Chris Richardson has predicted a change of government will like see 'an uptick of Commonwealth positions in Canberra'[13], further increasing upward pressure on population.

This submission questions the extent to which risk management has been factored in to the AER's draft determination, and questions whether the $2.4 million forecast for Evoenergy's vegetation management schedule reliably allows enough room to engage in best practice vegetation management over the 5410 kilometer circuit operated by Evoenergy[14].

The risk of fire in Canberra and the ACT is rising at the same time as Evoenergy is, for the first time, primarily responsible for vegetation management across its network. Legislative changes in the ACT mean that Evoenergy, as the sole DNSP, is responsible for incurring the costs of vegetation management aimed at mitigating the bushfire threat.

The determination by the AER to offer only $2.4 million per annum on vegetation management appears insufficient to meet the scale of the challenge in ensuring all bushfire risks have been considered and actioned by Evoenergy staff. This submission notes that the $2.4 million estimate of the per annum cost to Evoenergy is less than 0.27 per cent of the overall quantum of revenue the AER have suggested Evoenergy can recover from customers over the forward regulatory period.

This submission estimates the $2.4 million would only enable around a dozen FTE, after incurring associated costs to be proactively engaged in vegetation management and bushfire risk reduction. Evoenergy already has a track record of outsourcing vegetation management (as documented in the 2015 AER ActewACT final determination). The McKell Institute and ETU

[11] http://esa.act.gov.au/wp-content/uploads/The-ACT-Strategic-Bushfire-Management-Plan.pdf
[12] https://www.canberratimes.com.au/canberra-news/international-students-propping-up-act-s-fast-population-growth-20181022-p50b79.html
[13] Ibid.
[14] AER – Evoenergy 2019-2024 – Draft decision – Opex econometric modelling – October 2018.

NSW believe the limited resourcing suggested for vegetation management is inadequate given the scale of the network and the high bushfire risk across the entirety of the ACT.

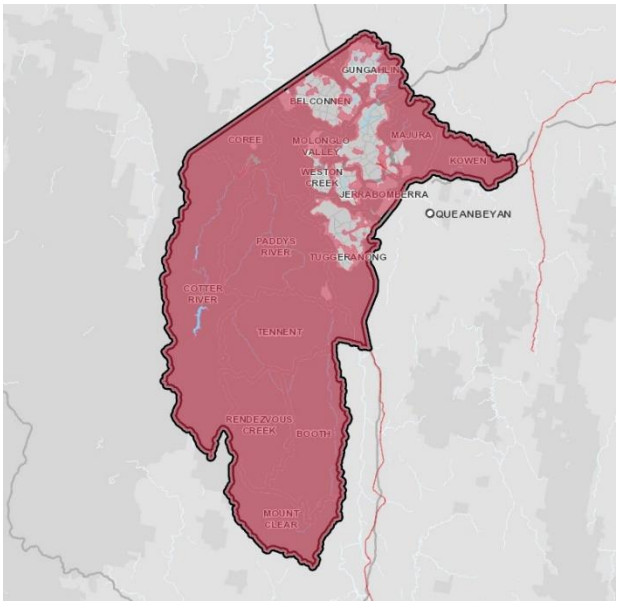

Figure 6.4: Map of high-risk bushfire areas in the ACT. Almost the entirety of the ACT is at the highest risk of bushfire possible[15]*.*

Evoenergy have previously fallen short of their vegetation management responsibilities

Previous AER regulatory decision found ActewAGL (Evoenergy) insufficient in meeting their vegetation management responsibilities

The Final decision 2014-19 by AER found the ActewAGL:

> 'did not act prudently and efficiently to manage costs associated with increased vegetation growth that occurred prior to 2012–13 because its vegetation management practices and its strategic and tactical responses were inadequate'

And that:

> "evidence of inefficient vegetation management costs in 2012–13 exists due to the manual processes between the office and field and the extent of clearance work that was deemed to be urgent, and which was therefore undertaken with a resultant

[15] http://app.actmapi.act.gov.au/actmapi/index.html?viewer=bushfire

higher cost. **It is EMCA's view that a service provider acting to efficiently minimise costs would have incurred a lower level of urgent clearance work."**[16]

Effectively, the AER had documented the ActewAGL (now Evoenergy) were not proactive enough in managing vegetation. This resulted in more emergency vegetation management which ultimately comes at a higher cost, impacted Evoenergy's OpEx results and, inevitably, costing consumers more.

Additionally, the 2015 final regulatory decision noted the ActewAGL had a tendency to outsource vital vegetation clearance work:

> "there was a lack of compelling evidence to demonstrate that ActewAGL's labour costs in 2012–13 were reflective of an efficient service provider. EMCa consider this was evident by the **relatively high level of internal resources used and the extent to which work was outsourced on an hourly rate bases for the urgent clearance of vegetation.**"

Considering this finding – as published by the AER itself – and the new policy which stipulates that Evoenergy is now responsible for more vegetation management than in previous regulatory periods, it is likely that the $2.4 million estimate of Evoenergy's vegetation management costs is insufficient. The AER should re-consider its $2.4 million finding, while ensuring that Evoenergy does utilise the full resources expected by the AER in its final decision later in 2019.

Deferring risk to consumers

The McKell Institute and ETU NSW believe that any reduction in the capacity of Evoenergy or any other DNSP to fully execute their responsibilities in vegetation management (or asset management and maintenance) risks greater incidents of outages and potentially fires. In the end, there are always costs associated with network interruptions and with bushfires, irrespective of their duration or size. During severe weather events, poorly managed vegetation is more likely to cause service disruptions.

If Evoenergy experiences such outages having already been constrained in its capacity to pre-emptively manage such risk, there will be two likely outcomes: first, Evoenergy may have to assume extra, unnecessary costs that could have been mitigated with better vegetation

[16] https://www.aer.gov.au/system/files/AER%20-%20Final%20decision%20ActewAGL%20distribution%20determination%20-%20Overview%20-%20April%202015_0.pdf

management, or second, that consumers will end up wearing the costs of service repairs. If expenses relating to maintenance and vegetation management is too drastically reduced, larger and longer outages may result. The additional emergency op-ex associated with such events would further undermine Evoenergy in relation to efficiency benchmarking, and potentially incentivise Evoenergy to reduce op-ex in other areas.

The AER must demonstrate a clearer understanding of the total costs of potential service outages or even bushfire events that could occur given the enormous vegetation management task of Evoenergy.

Low vegetation management OpEx allocation likely to result in cost pass throughs to consumers

On 7 December 2018, Evoenergy applied for cost pass throughs in relation to vegetation management:

> "The new obligations arise from amendments to the Utilities (Technical Regulation) Act 2014 (the Act) which took effect from 1 July 2018 . There are two new areas of responsibility transferred to Evoenergy by the amendments to the Act. These are responsibility for the:
>
> - clearance of vegetation near aerial lines on unleased territory land, rural leased land, and national land ; and
> - inspection of electrical infrastructure on rural leased land outside the network boundary, issue of written notices to owners to repair and restore the electrical infrastructure to a safe state and, if the owner does not comply with a notice, conduct of repairs and restoration of the electrical infrastructure to a safe state, with the debt due by the owner."[17]

In its assessment, the McKell Institute and ETU NSW submit that there is a considerable risk of cost overrun in terms of vegetation management, and that, inevitably, any additional costs associated with vegetation management that are beyond the $2.4 million annual figure determined by the AER will be borne by consumers.

The current model of vegetation management sees that Evoenergy experts oversee and manage contracted labourers who engage in the physical removal and/or pruning of vegetation. In The McKell Institute and ETU NSW's assessment, many individual contractors

[17]https://www.aer.gov.au/system/files/Evoenergy%20vegetation%20management%20pass%20through%20application.pdf

involved in vegetation management would be remunerated above $100 per hour for their service, and that, often, more than one individual is involved in the pruning of vegetation.

Previous AER advice has argued that hourly rate models of contracting are 'generally associated with higher costs'[18]. This is the case with the vegetation management model.

Inevitably, given the scale of the vegetation management Evoenergy faces, the $2.4 million p/a vegetation management expense estimate is certain to be surpassed. These costs will likely be passed on to consumers. If they are not, they will further undermine Evoenergy's OpEx results for future benchmarking exercises, and potentially place further pressure on Evoenergy to reduce OpEx in a way that meets AER expectations, which this submission has made clear is often the reduction in workforce.

A note on best practice vegetation management

It is important that the AER ensures that Evoenergy, in executing its responsibility to manage vegetation in order to prevent unnecessary disruptions and bushfire risks, has the resources and capacity to not only manage vegetation, but do so effectively and sustainably.

The ACT is unique in its natural environment. As a major urban centre within close proximity to the natural environment, it is vital that any vegetation management does not damage beyond necessity the ACT's unique environment. Environmental researchers have determined the regular pruning of hazardous trees and vegetation is the preferred method of vegetation management[19]. Not only does well-considered vegetation management reduce the risk of bushfires and network disruption, it also minimised impact on the ecosystem. It is important that best-practice vegetation management be considered by the AER and factored into its forecasting, and that AER determinations incentivise best-practice vegetation management, not inferior or reactive management practices.

[18]https://www.aer.gov.au/system/files/AER%20Final%20Determination%20on%20ActewAGL%20vegetation%20management%20cost%20pass%20through%20-%20Appendix%20B.pdf

[19] Dupras, J. 2016. 'Management of vegetation under electric distribution lines will affect the supply of multiple ecosystem services'. *Land Use Policy*, 2016.

Concluding Remarks

The McKell Institute and the ETU NSW have put forward this submission to express concerns over certain elements of the AER's *Draft Determination: Evoenergy Regulatory Period 2019-2024.*

Of primary concern to The McKell Institute and ETU NSW is the lack of consideration regarding frontline workers, and the under-allocation of resources towards vegetation management, that is evidence in the draft determination.

The AER plays a pivotal role in the regulation of a complex, highly diverse and sizeable industry which affects every Australian. It is understandable that the AER seeks to regulate the DNSPs so that they produced reliable, affordable services for Australian energy consumers.

This submission, however, notes that the benchmarking methodology adopted by the AER risks incentivising DNSPs to reduce opex primarily through cutting labour and associated costs. This has consequences for not only the workers themselves, but also the future of the industry and, ultimately, consumers.

DNSPs require highly skilled labour. Excessively incentivising cost reductions in labour and training risks de-skilling the industry. Further, actively reducing workforces results in DNSPs engaging in 'reactive maintenance', which occurs more frequently when networks are not adequately pre-emptively maintained.

Additionally, vegetation management has been ill-considered by the AER. This submission has noted at length that the resources available to the AER are inadequate in meeting their objectives. Further consideration on vegetation management costs must be considered by the AER before the final determination is reached.

Broadly, the McKell Institute and the AER see this draft determination as an opportunity for the AER to better consider the long and short term consequences on electrical trade workers of its determinations, and further ensure that the AER is meeting is mandate of providing both a reliable, affordable and efficient network, while ensuring safety and the future interests of workers are considered.