

Addendum to Attachment 5 [Capital Expenditure] of the Revised Proposal

Bushfire Risk Review – Proposed Contingent Project

This document is an addendum to Attachment 5 [Capital Expenditure] of our revised proposal for the 2020-25 regulatory control period (**2020-25 RCP**). Our revised proposal for the 2020-25 RCP (**Revised Proposal**) was submitted on 10 December 2019.

This Addendum proposes an additional proposed contingent project for the 2020-25 RCP (the **Bushfire Risk Review Contingent Project**) and provides detailed information in support of our request for the AER to determine that the Bushfire Risk Review Contingent Project should be included as a contingent project in our final determination for the 2020-25 RCP.

New information that has come to light since the lodgement of our Revised Proposal

In the period since we lodged our Revised Proposal, large parts of south-eastern Australia have experienced devastating bushfires. In South Australia, parts of the Adelaide Hills, the lower Yorke Peninsula and Kangaroo Island have been severely affected, with the bushfires causing major property damage and, tragically, loss of life.

These events and the resulting impacts have prompted the South Australian Government to initiate a review aimed at reducing bushfire risk.

On 7 January 2020, SA Power Networks met with representatives from the State Government and the Essential Services Commission of South Australia (**ESCOSA**) to discuss bushfire risk management practices. The State Government indicated during that meeting a desire to investigate how effectively electricity infrastructure is being managed in view of the increasing fire risk being experienced during the current fire season. The State Government also intends to investigate the potential implications and ramifications of an increasing bushfire risk profile due to climate change during future years. The State Government will therefore ask ESCOSA to write to SA Power Networks to conduct a review of bushfire risk management practices (**Bushfire Risk Review**) which review will extend to the management of electricity infrastructure in high and medium bushfire risk areas¹.

The State Government has indicated that the Bushfire Risk Review will be in two parts:

1. An assessment of preparedness for the current and next bushfire season, including any lessons learned from the first two months of the current season (November and December 2019).
2. A longer-term review of the increasing bushfire risk being posed by climate change and how SA Power Networks needs to adapt its operational and construction practices to deal with the increasing bushfire risk.

The reference to adapting SA Power Networks' construction practices to deal with the increasing bushfire risk is of particular importance to this Bushfire Risk Review Contingent Project.

SA Power Networks is very keen to engage with the State Government, ESCOSA, community groups and other stakeholders as part of the Bushfire Risk Review. We believe it is in the long-term interests

¹ The specific locations within SA Power Networks' distribution network which are high and/or medium bushfire risk areas are identified in the *Electricity (Principles of Vegetation Clearance) Regulations 2012* (SA).

of our customers, and the broader community, that we explore all possible options for reducing and managing bushfire risk. It is clear from the proposed scope of the Bushfire Risk Review that these options may include:

- further investment in our network to enhance remote operation of assets in high and medium bushfire risk areas; and
- changes to our construction practices (such as increased undergrounding),

aimed at reducing fire start risk.

However, we are concerned that our ability to support the recommendations of the Bushfire Risk Review and the State Government's response to those recommendations will be severely limited if there is no clear mechanism for the recovery of the additional costs associated with new investments we are required to make in relation to our distribution network during the 2020-25 RCP under new or change regulatory obligations or requirements which are enacted to implement the recommendations of the Bushfire Risk Review.

As noted in our Revised Proposal, the 2019 AER benchmarking report has confirmed that SA Power Networks provides the most efficient distribution services in the NEM on a State-wide basis. Notwithstanding this fact, the AER has proposed in its draft determination to reduce our forecast capex to a level which is less than our actual capex during the 2015-20 RCP.

Whilst we have argued against this reduction in our Revised Proposal, the forecast capex that is included in the AER's final determination will by definition² reflect the efficient and prudent costs of achieving the capital expenditure objectives and, in particular, complying with all applicable regulatory obligations or requirements associated with the provision of standard control services at that time. It will not therefore include the efficient and prudent costs of complying with new or changed regulatory obligations or requirements which are enacted by the State Government during the 2020-25 RCP to give effect to the recommendations of the Bushfire Risk Review.

If:

- SA Power Networks is already ranked at the top end of the efficiency benchmarking data; and
- the forecast capital expenditure that is included in the AER's final determination reflects the efficient and prudent costs of complying with all applicable regulatory obligations or requirements associated with the provision of standard control services at that time,

funding new investments during the 2020-25 RCP that are required under this type of new or changed regulatory obligations or requirements will mean that other investments which have already been assessed as efficient and prudent will need to be deferred to the next regulatory control period.

We have therefore proposed an additional contingent project for the 2020-25 RCP to account for new network investments during the 2020-25 RCP that are required in order to achieve the bushfire risk reduction initiatives that are:

- recommended by the Bushfire Risk Review; and

² This is the required outcome from the clause 6.5.7 processes.

- selected by, or on behalf of, the State Government and required to be commenced or implemented by SA Power Networks during the 2020-25 RCP as a consequence of a change to an existing regulatory obligation or requirement or the enactment of a new regulatory obligation or requirement that gives effect to the recommendations of the Bushfire Risk Review.

Our proposed contingent project is outlined below.

Proposed contingent project

SA Power Networks is entitled under clause 6.6A.1(a) of the National Electricity Rules (**NER**) to include in its Revised Proposal, the total forecast capital expenditure which SA Power Networks considers will reasonably be required for the purpose of undertaking a proposed contingent project. The term 'proposed contingent project' is defined in Chapter 10 of the NER to mean a proposal by SA Power Networks for a project to be determined by the AER in accordance with clause 6.6A.1(b)(1) of the NER as a contingent project for the purposes of the SA Power Networks distribution determination for the 2020-25 RCP.

The Bushfire Risk Review Contingent Project is clearly a project within the ordinary meaning of that term and SA Power Networks is submitting that proposed contingent project for consideration by the AER in accordance with clause 6.6A.1(b) of the NER.

The proposed contingent project will cover the investments that are:

- recommended by the Bushfire Risk Review to be implemented by SA Power Networks in relation to its distribution network; and
- selected by, or on behalf of, the State Government and required to be commenced or implemented by SA Power Networks in relation to its distribution network during the 2020-20 RCP as a consequence of a change to an existing regulatory obligation or requirement or the enactment of a new regulatory obligation or requirement that gives effect to the recommendations of the Bushfire Risk Review.

As noted above, the Bushfire Risk Review is expected to closely examine the risks of fire starts given recent bushfire events and expected continuing extreme fire weather conditions. A possible finding of the review may be that the relevant fire start risks have increased, and additional investment is now required to maintain the safety of the distribution system and mitigate, reduce or avoid the increased bushfire risks. This could include investment in new equipment and systems:

- to allow for the quicker identification of fire start risks and the remote operation and control of network assets to reduce fire start risk;
- to remove fire start risks in high bushfire risk areas by undergrounding identified elements of the distribution network located within those high bushfire risk areas; and
- to otherwise maintain the safety of the distribution system with respect to fire start risks.

If the State Government (either directly or through ESCOSA) decides to change an existing regulatory obligation or requirement or enact a new regulatory obligation or requirement that requires SA Power Networks to commence to implement this type of network investment, it is likely that SA Power Networks will be required to commence to undertake these investments quite quickly – almost certainly within the 2020-25 RCP.

Obviously, if the type of investment that is recommended by the Bushfire Risk Review is already included within SA Power Networks' current capital expenditure forecast for the 2020-25 RCP (i.e. falls within the bushfire risk capital expenditure for the 2020-25 RCP that has already been assessed and approved by the AER as efficient and prudent in the AER's draft determination and included within our Revised Proposal) it will not form part of the Bushfire Risk Review Contingent Project. We expect that this will be made clear in the AER's final determination concerning the Bushfire Risk Review Contingent Project and this certainly reflects our intention when proposing this proposed contingent project.

Proposed contingent capital expenditure

Clause 6.6A.1(b) of the NER provides that the AER must determine that a proposed contingent project is a contingent project if the AER is satisfied that the proposed contingent project and associated proposed contingent capital expenditure and trigger events meet the requirements listed in clause 6.6A.1(b)(1) to (4) and clause 6.6A.1(c) of the NER.

The total forecast capital expenditure for the Bushfire Risk Review Contingent Project (i.e. the proposed contingent capital expenditure) will obviously depend on:

- the final recommendations of the Bushfire Risk Review;
- the State Government's decision concerning the recommendations it wants implemented during the 2020-25 RCP via changes to existing regulatory obligations or requirements or the enactment of a new regulatory obligation or requirement;
- the options for addressing the changed or new regulatory obligations or requirements;
- the outcomes from the completion of the RIT-D processes with respect to the credible options for addressing the changed or new regulatory obligations or requirements; and
- the outcome from the AER's assessment under clause 6.6A.2 of the NER.

However, whilst the total forecast capital expenditure for the Bushfire Risk Review Contingent Project is not known at this stage, it is clear that the forecast capital expenditure for the Bushfire Risk Review Contingent Project will (when it is known) satisfy the requirements listed in clauses 6.6A.1(b)(1) and (2)(i), (ii) and (iii) of the NER.

Clause 6.6A.1(b)(1)

The AER must be satisfied that the proposed contingent project (i.e. the Bushfire Risk Review Contingent Project) is reasonably required to be undertaken in order to achieve any of the capital expenditure objectives.

As noted above, the Bushfire Risk Review Contingent Project is limited to forecast capital expenditure that is required during the 2020-25 RCP to comply with a change to an existing regulatory obligation or requirement or the enactment of a new regulatory obligation or requirement that gives effect to the recommendations of the Bushfire Risk Review (i.e. the capital expenditure objective referenced in clause 6.5.7(a)(2) of the NER). This type of new or changed regulatory obligation or requirement is clearly not included within the forecast capital expenditure that will be included within the AER's final determination for the 2020-25 RCP because the regulatory obligation or requirement does not currently exist.

Depending upon the nature of the investment which is required to be undertaken during the 2020-25 RCP under this type of new or changed regulatory obligation or requirement, the forecast capital expenditure may also be required to maintain the safety of the distribution system through the supply of standard control services (i.e. the capital expenditure objective referenced in clause 6.5.7(a)(4) of the NER).

It follows that the AER should be satisfied that the Bushfire Risk Review Contingent Project is reasonably required to be undertaken in order to achieve at least one of the capital expenditure objectives.

Clause 6.6A.1(b)(2)(i)

The AER must be satisfied that the proposed contingent capital expenditure is not otherwise provided for (either in part or in whole) in the total forecast capital expenditure for the 2020-25 RCP that is assessed and approved by the AER as being efficient and prudent.

As noted above, the total forecast capital expenditure for the Bushfire Risk Review Contingent Project will not under the terms of our proposal include forecast capital expenditure that is otherwise provided for (either in part or in whole) in the total of the forecast capital expenditure for the 2020-25 RCP that is assessed and approved by the AER as being efficient and prudent. The proposed contingent project is limited to new investments in relation to our distribution network that are required to be undertaken during the 2020-25 RCP solely in order to comply with a change to an existing regulatory obligation or requirement or the enactment of a new regulatory obligation or requirement that gives effect to the recommendations of the Bushfire Risk Review. It cannot include, under our proposal, forecast capital expenditure that is already provided for under the total of the forecast capital expenditure for the 2020-25 RCP included in the AER's final determination.

It follows that the AER should be satisfied that the proposed contingent capital expenditure is not otherwise provided for (either in part or in whole) in the total forecast capital expenditure for the 2020-25 RCP.

Clause 6.6A.1(b)(2)(ii)

The AER must be satisfied that the proposed contingent capital expenditure reasonably reflects the capital expenditure criteria, taking in account the capital expenditure factors, in the context of the Bushfire Risk Review Contingent Project.

Given that the total forecast capital expenditure for the Bushfire Risk Review Contingent Project will be determined in accordance with the RIT-D process and the AER's assessment under clause 6.6A.2 of the NER, it will clearly reflect the capital expenditure criteria taking into account the capital expenditure factors.

For example, the completion of these processes will ensure that the total forecast capital expenditure for the Bushfire Risk Review Contingent Project reflects the efficient and prudent costs of complying with the new or changed regulatory obligation or requirement giving effect to the recommendations of the Bushfire Risk Review and taking into account cost inputs at that time.

The completion of these processes will also promote and satisfy the factors set out in clauses 6.5.7(e)(4) to (11) of the NER. For example, both the RIT-D process and the AER's assessment process under clause 6.6A.2 of the NER will include comprehensive consultation processes which will provide stakeholders with a number of opportunities to input into the efficiency and prudence of the total forecast capital expenditure for the Bushfire Risk Review Contingent Project. These consultation

processes will be in addition to any consultation process which is undertaken as part of the Bushfire Risk Review or by the State Government or ESCOSA when deciding what additional or changed obligations should be imposed upon SA Power Networks during the 2020-25 RCP with respect to the construction, operation or maintenance of its distribution network to give effect to the recommendations of the Bushfire Risk Review.

In addition, the RIT-D process will specifically consider substitution possibilities between operating expenditure and capital expenditure, and efficient and prudent non-network options.

It follows that the AER should be satisfied that the proposed contingent capital expenditure will reasonably reflect the capital expenditure criteria, taking in account the capital expenditure factors because the requirements of the RIT-D process and the AER's assessment process under clause 6.6A.2 of the NER will ensure that this is the case.

Clause 6.6A.1(b)(2)(iii)

The AER must be satisfied that the proposed contingent capital expenditure will exceed either \$30 million or 5% of the value of SA Power Networks annual revenue requirement for the 2020/21 regulatory year, whichever is the larger amount.

Taking into account the forecast capital expenditure for the bushfire risk mitigation and safety measures that were included in our regulatory proposal for the 2015-20 RCP, we think that the total forecast capital expenditure for the Bushfire Risk Review Contingent Project is likely to exceed the threshold set out in clause 6.6A.1(b)(2)(iii) of the NER. In our Revised Proposal for the 2015-20 regulatory control period, we proposed \$67 million in capital expenditure for bushfire risk mitigation and safety measures, revised down from an initial proposal of \$203 million. Whilst this proposal was not accepted by the AER, it provides an indication concerning the potential quantum of capital expenditure that may be required to comply with this type of new or changed regulatory obligation or requirement.

Whilst the total forecast capital expenditure for the Bushfire Risk Review Contingent Project is not known at this stage because the extent of the required investment in relation to our distribution network will depend upon the outcomes from the Bushfire Risk Review and the State Government's subsequent decisions in relation to the scope of the required investment during the 2020-25 RCP, we think it is very likely that the total forecast capital expenditure for the Bushfire Risk Review Contingent Project will exceed this threshold.

In any event, we would obviously not make an application to amend our distribution determination under clause 6.6A.2(a) of the NER if the total forecast capital expenditure for the Bushfire Risk Review Contingent Project did not exceed this threshold. In addition, the AER is able to reject our application if the AER is not satisfied that the total forecast capital expenditure for the Bushfire Risk Review Contingent Project will exceed this threshold.

We therefore think that the AER should be satisfied that the proposed contingent capital expenditure will exceed this threshold.

Clause 6.6A.1(b)(3)

The information that SA Power Networks will provide to the AER in its application to amend its distribution determination under clause [6.6A.2\(a\)](#) and (b) following the occurrence of the trigger events will satisfy this requirement (i.e. any information that SA Power Networks is required to provide with its application and during the subsequent consultation, will comply with the relevant

requirements of the reset RIN as if the proposed contingent project and proposed contingent capital expenditure had been included as part of the forecast capital expenditure for the 2020-25 RCP in SA Power Networks regulatory proposal.

Clause 6.6A.1(b)(4) - proposed trigger events

The AER must be satisfied that the trigger events in relation to the proposed contingent project are appropriate having regard to the requirements listed in clause 6.6A.1(c) of the NER.

SA Power Networks proposes the following trigger events for the Bushfire Risk Review Contingent Project:

1. Publication of a final report by the Bushfire Risk Review which includes a recommendation that new investment is required to be undertaken by SA Power Networks to reduce the risk of fire starts or improve bushfire safety in high and/or medium bushfire risk areas;
2. Imposition of a new or changed regulatory obligation or requirement on SA Power Networks which requires SA Power Networks to commence to undertake investment in relation to its distribution network to reduce the risk of fire starts or improve bushfire safety in high and/or medium bushfire risk areas during the 2020-25 RCP; and
3. Successful completion of the RIT-D in relation to the investment required to satisfy the new or changed regulatory obligation or requirement including an assessment of credible options and the identification of the preferred option.

SA Power Networks proposes that if these events were to occur during the 2020-25 RCP, it would be able to apply to the AER under clause 6.6A.2(a) of the NER to amend its distribution determination.

Importantly, completion of the RIT-D in relation to the required investment would require SA Power Networks to:

- identify and scope the capital works that are required to comply with the changed or new regulatory obligation or requirement;
- for each part of those capital works, forecast the capital expenditure required to comply with the changed or new regulatory obligation or requirement;
- consider non-network options for addressing the identified need; and
- assess the economic efficiency of each of the credible options and select the preferred option which provides the greatest benefit relative to cost.

This process, along with the process for assessing whether the trigger event has occurred and the AER's assessment process under clause 6.6A.2 of the NER, will provide the AER with ample opportunity to consult with stakeholders and assess the proposed capital expenditure at a time when the final scope and forecast cost of the investment are sufficiently certain. If the AER requires more time to consider the application and consult with stakeholders, it is able under clause 6.6A.2(j) to extend the time limit for a further period of 60 business days.

We consider that the combination of these 3 trigger events are appropriate having regard to the matters set out in clause 6.6A.1(c) of the NER. These events are specific and are clearly capable of objective verification. Moreover, if the trigger events were to occur, SA Power Networks would be

required under the changed or new regulatory obligation or requirement to undertake the relevant investment during the 2020-25 RCP in order to comply with its regulatory obligations or requirements (i.e. in order to achieve capital expenditure objective listed in clause 6.5.7(a)(2) of the NER).

As noted above, this increase in capital expenditure would relate to specific locations (i.e. high and/or medium bushfire risk areas) rather than to the distribution network as a whole.

Finally, it is probable based on discussions to date with the State Government that the Bushfire Risk Review will be completed and at least some of the recommendations implemented by the State Government changing existing regulatory obligations or requirements or enacting new regulatory obligations or requirements during the 2020-25 RCP. This requirement has been built into the second trigger (i.e. the second trigger will only be satisfied if the new or changed regulatory obligation requires SA Power Networks to commence to undertake the required investment during the 2020-25 RCP).

Conclusion

SA Power Networks believes that the proposed Bushfire Risk Review Contingent Project will be in the long-term interests of consumers of electricity because it promotes transparency and gives the AER and other stakeholders comfort that SA Power Networks is using all reasonable endeavours to minimise the cost relating to the project whilst ensuring that it complies with its regulatory obligations and requirements and in all cases maintains the safety of its distribution system from increasing fire risks and the devastating implications bushfires can have on the community.