10 November 2020

Claire Preston
Australian Energy Regulator
Level 17, Casselden Place
2 Lonsdale Street
Melbourne VIC 3000

Dear Claire

Re: Draft 2020 benchmarking results for Distribution Network Service Providers

Thank you for the 2020 distribution network service providers (DNSP) Draft Benchmarking results and the opportunity to provide further comments. Please see some feedback below.

1.   **2019 results**

Our multilateral total factor productivity (MTFP) remained broadly similar between 2018 and 2019 (decreasing by 0.3 per cent) as did capital productivity, in line with the trend for productivity levels across the industry to converge over time.[1] As noted in section 5.1 of the AER's Draft Benchmarking Report, our opex efficiency decreased between 2018 and 2019. This was due to an increase in opex in 2019 compared to 2018, which was largely driven by increased GSL payments due to the December 2019 bushfires and higher expenditure on vegetation management, due to the phasing of our program.

2.   **Capitalisations**

We welcome the AER's measures to investigate DNSP's different cost allocations and capitalisation approaches. However, the analysis does not adequately address how different DNSP capitalisation approaches materially impact the AER's opex benchmarking results. As demonstrated below, it is a fact that the current benchmarking results are materially impacted by the AER's application of historical capitalisation policies for some businesses which significantly understates actual opex paid for by customers, for the purposes of benchmarking.

As acknowledged in the AER's Draft Benchmarking Report,[2] we have consistently provided submissions discussing the effects of how different DNSP capitalisation approaches materially impact the AER's opex benchmarking results. For example, the below charts show Opex Partial Factor Productivity (OPFP) performance of all DNSPs as per the AER's benchmarking report, where Powercor and CitiPower's opex has been adjusted to align with their previous capitalisation policies, and the benchmarking results using distributors' opex as reported in the RINS. As can be seen below, the benchmarking results change significantly depending on

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[1] Australian Energy Regulator, 2020 Annual Benchmarking Report Electricity distribution network service providers (November 2020), section 4.2.2.

[2] Ibid, p 77.

which capitalisation approach is used, with Powercor's performance decreasing and CitiPower dropping in ranking from second to ninth position. This analysis stands regardless of whether DNSPs' opex to totex ratios are similar.

Stakeholders and customer representatives often lament that the DNSP productivity performance remains disparate and highly variable. Interestingly, once capitalisation differences are removed the analysis shows the convergence in performance over time expected from a benchmarked regime. By allowing significantly different capitalisation splits the AER risks undermining its own success story.
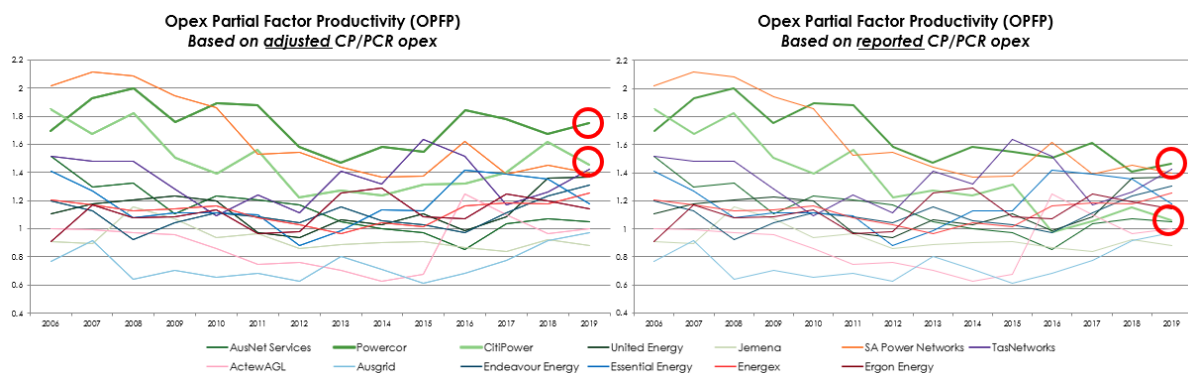
Source: Draft 2020 benchmarking results for Distribution Network Service Providers, Regulatory Information Notices

Given that these different approaches do not ultimately contribute to productivity, this indicates a standardised approach to the allocation of overheads is required to ensure the credibility of the benchmarking results.

There is no clear reason why the AER's benchmarking applies actual opex for some businesses, and materially reduces actual opex for other businesses. The AER's conclusion that capitalisation practices are not materially different between businesses supports the use of actual opex for **all** businesses. This is the only way to make meaningful and fair benchmarking comparisons.

3. Revised output weights

As noted in our feedback in to the preliminary results, while the corrected output weights are skewed towards circuit length, we would expect that customer numbers would be of central importance to the functions carried out by a DNSP and should be represented with a higher weighting.

Indeed this was acknowledged in the AER's 2015 Benchmarking report, which noted the following:

> "The primary function of a distribution network is providing its customers with access to electricity. Regardless of how much electricity a customer consumes, infrastructure is required to connect every customer to the network. The number of customers, therefore, reflects a significant driver of the services a DNSP provides."[3]

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[3] Australian Energy Regulator, Annual Benchmarking Report Electricity distribution network service providers (November 2015), p 19.

We are not challenging the accuracy of the model corrections, rather we consider that the methodology itself should be reviewed in light of these results.

4. GSLs

Given possible substantial changes to Victoria's GSL scheme, the inclusion of GSL payments in benchmarked opex should be revisited.

The benchmarking regime rightly already captures the reliability of the network as a negative output. It is not clear why GSL payments should also be included in the analysis as they do not represent the underlying reliability of the network. Indeed, average GSL payments have remained stable even as network reliability has been dramatically improved over the last decade. Essentially GSL payments for each network have tended to move in a random walk closely related to storm activity.

As such, GSL payments are largely an internal transfer from high reliability customers to low reliability customers. The size of the transfer is determined not by productivity but by thresholds set by the jurisdiction and by the underlying design and environment of the distributor.

This issue will be brought into focus in Victoria, where potential changes to the GSL thresholds and design may increase the transfer payments substantially. This will manifest as higher GSL payments and give the illusion that opex productivity for the affected networks will have declined substantially even though opex productivity will not have changed.

5. Operating environment factors (OEFs)

Lastly, we welcome the developments in relation to quantifying OEFs. We would be interested in further information that can be shared about the analysis and look forward to working with the AER to further develop them in future.

If you would like to discuss any aspect of this submission, please contact ▮▮▮▮▮▮▮▮▮▮

Sincerely

Charlotte Eddy

Manager Economic Regulation

AusNet Services