

26 October 2022

Claire Preston  
Director – Network Expenditure  
Australian Energy Regulator

Dear Claire

### **RE: AER's Draft 2022 Distribution Benchmarking Report**

We appreciate the opportunity to comment on the AER's Draft 2022 Distribution Benchmarking Report, and the broader engagement with the AER to date.

AusNet has long supported the AER's use of benchmarking to provide insights into the productivity of distribution networks. However, there has not been a holistic review of the current benchmarking models since they were developed in 2014, and substantive concerns raised repeatedly by AusNet and other networks in recent years about the Opex Partial Factor Productivity (OPFP) and Operating Environment Factors (OEFs) in particular have not been adequately addressed.

Stakeholders including the Customer Challenge Panel place weight on the benchmarking results in reaching conclusions about networks' productivity, particularly in the lead up to and during regulatory resets. As a result, in line with our previous submission, we recommend that:

1. The AER urgently undertake and complete a holistic review of the current benchmarking model, including OEFs. This is required to ensure stakeholder confidence in the models and provide certainty to businesses on AER's assessment approach to base year opex for the upcoming round of regulatory resets.
2. In the interim, the AER should include some sensitivity analysis in its 2022 benchmarking report, to provide additional relevant information to stakeholders and to guide future discussions. This should include:
  - Charts showing the impact of using reported opex (instead of benchmarked opex) as it establishes a clear link between benchmarking results and the level of opex that customers are actually paying for. Benchmarked opex excludes some materially large opex for some businesses and not others.
  - Charts showing the impact of excluding Guaranteed Service Levels (GSLs) and Natural Disaster Pass Through amounts from reported opex as these costs are completely exogenous, material, very lumpy and disproportionately affects some networks and not others.
  - Charts showing the impact of OEFs which have been developed and quantified to date.

We are also concerned about the AER's post-modelling adjustments to account for the transition from calendar to financial years for the Victorian networks, and Quantonomics' discussion of AusNet's opex inputs. Lastly, we support ENA's position that, given the highly technical nature of the topic, the AER should undertake further consultation with network businesses on the Quantonomics memorandum that investigates possible options for addressing the ongoing performance issues with the opex economic cost function models.

### **Need to properly account for differences in operating environments**

We have previously provided information on vegetation management (division of responsibility), taxes and levies, capitalisation, and export services, which the AER must account for in developing their OEFs framework. In particular, we identified that the Taxes and Levies OEF data for AusNet included in the AER's latest OEF

spreadsheets (received in July 2022) did not appear to align with the latest data. We request confirmation that the latest taxes and levies data provided to the AER in April 2018 and on 30 August 2022 will be used going forward.

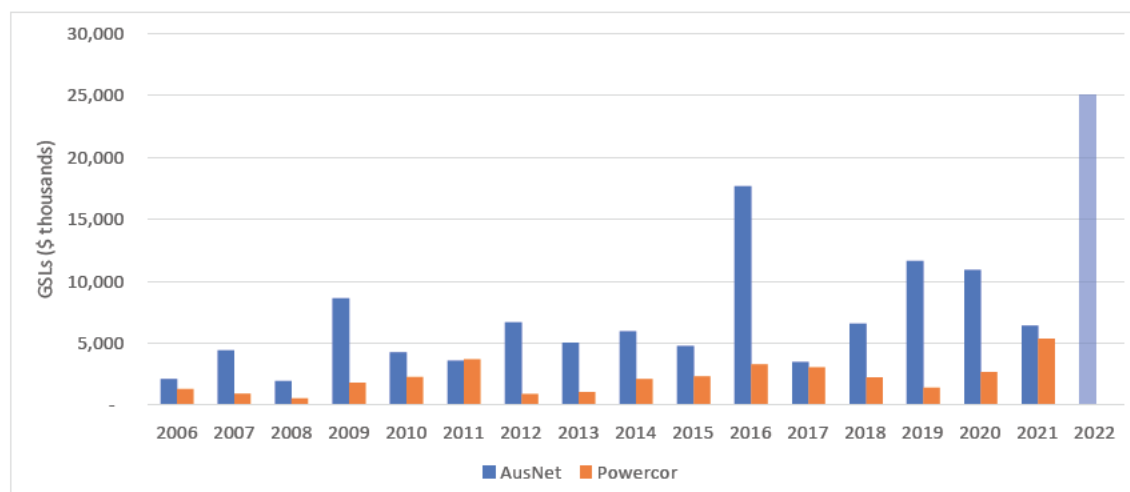
As communicated to the AER, in the next few weeks, we are intending to submit a proposed approach to developing OEFs to ensure the characteristics of our network are better reflected in the AER's opex assessment approach. This addresses recommendations of Sapere's 2018 OEF review.

### Guaranteed Service Level payments (GSLs)

We note that GSLs are listed as a forward work plan item for the AER. This issue can be quickly addressed. We have raised the following issues with GSLs over the last few years:

- **Transfer payment:** Customers receive GSLs as an output as well as an input, so there is no bearing on productivity. The current benchmarking models only count GSLs as an input and not an output. The models should be refined to include these payments as an output customers receive, or (more simply) GSLs should be excluded from benchmarking.
- **Differences in Major Event Days (MEDs):** Victoria is the only jurisdiction that is required to compensate customers for MED outages. We opposed this feature of the GSL scheme when the ESC introduced this as it exposes customers to the risk of higher costs due to environmental factors outside anyone's control and is not indicative of underlying network performance. Because this is a feature of the Victorian regime that does not apply in other states and drives substantial cost with no bearing on efficiency, these payments should be directly excluded from benchmarking.
- **Our network is disproportionately affected by storms and long outages:** The following chart shows that our GSLs have averaged \$6.5 million from 2006 to 2021 and have materially grown over time, compared to Powercor (the network with the second highest GSLs in Victoria) at \$2.2 million. The non-MED reliability payments also duplicate the reliability output included in the benchmarking, which double counts impacts of poor reliability on benchmarking.
- **June 2021 storms affected us disproportionately:** The Victorian Government made a Ministerial Order that compelled us to make GSL payments in excess of \$25 million despite the storm being eligible for exclusion under the Electricity Distribution Code. This amount should be excluded from benchmarking.

For all the reasons above, GSL opex should be excluded from benchmarking. Alternatively, GSLs should be recognised as both an input and output for benchmarking purposes.



### Post-modelling adjustment to account for the transition from calendar to financial years

AusNet's 2021 MTFP and OPFP change of 10.3% and 8.2%, is slightly unusual, and this is partially due to the index change from CY2020 to FY2021 being multiplied by two – this effectively assumes that the change from CY2020 to FY2021 occurred over 6 months, where the multiplication annualises the results. While we agree that results can be used in the 2022 benchmarking report, particularly given the complexities associated with

transitioning to financial years, we consider it is prudent and important to clearly state the annualisation assumption in the 2022 report.

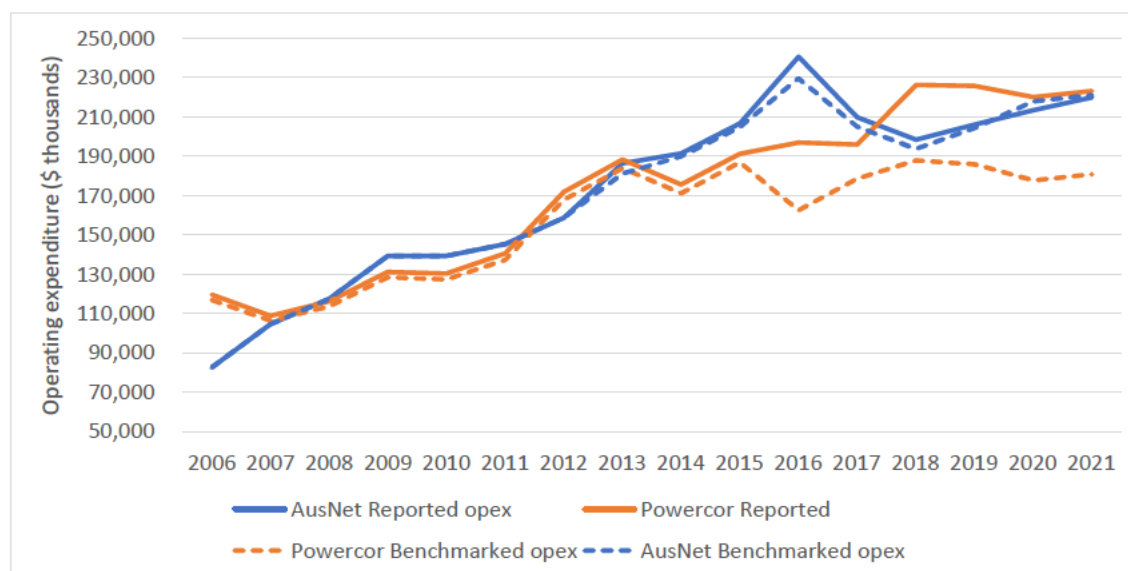
### Discussion of AusNet's opex

We are concerned by the statement in Quantonomics' report:

*...between 2006 and 2021, AusNet's opex input increased by 82.4 per cent in total compared to its output increasing by 26.3 per cent, which implies a very large decrease in OPFP. By contrast, Powercor's opex increased by 5.4 per cent in total over the same period compared to an output increase of 19.4 per cent, implying an improvement in OPFP. These large differences in trends are driven by different trends in opex. The substantial difference in OPFP levels in 2021 is entirely plausible since it follows directly from the opex data trends.<sup>1</sup>*

As shown below, this is not a reliable interpretation of the data and perfectly illustrates the issues with comparability and transparency of the benchmarking results that we have raised.

The large differences in opex inputs identified by Quantonomics is driven by the AER's methodology that allows Powercor to exclude materially large opex (to reflect a frozen CAM) from benchmarking (see chart below).



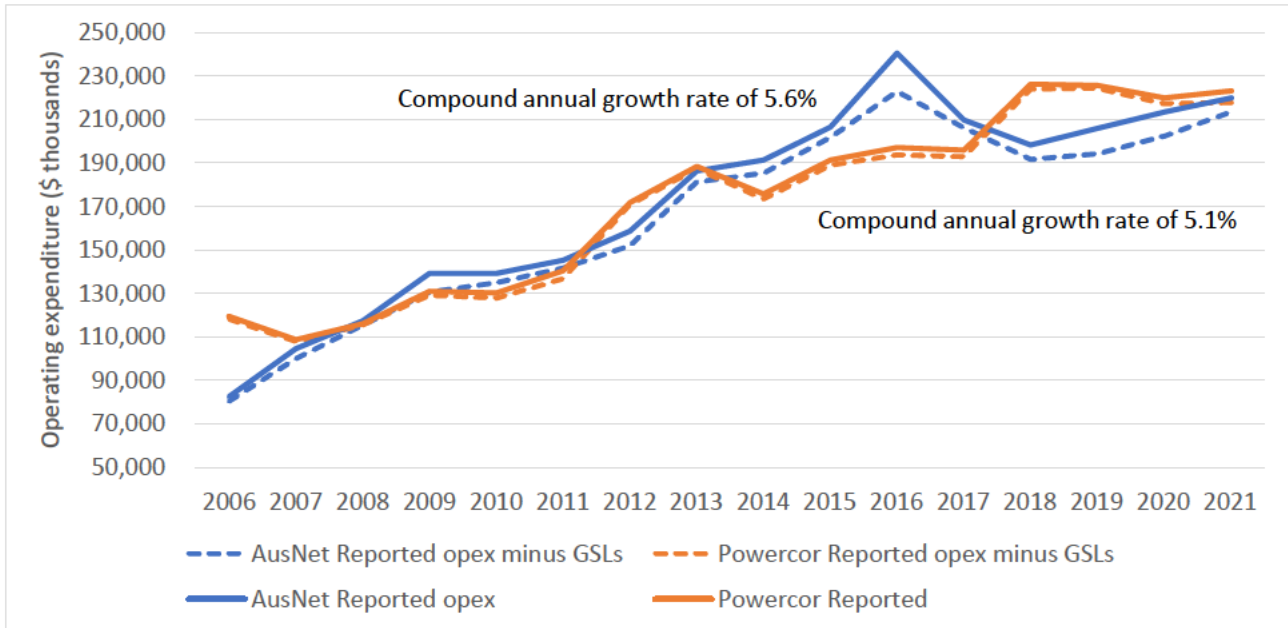
Quantonomics statement is also impacted by the selection of 2006 as the starting point, and AusNet's stronger growth in GSL payments.

The following chart shows that AusNet and Powercor's opex growth over the 2007 to 2021 period are very similar on the basis of Powercor's actual opex instead of benchmarked opex – compound annual growth rates of 5.6% and 5.1% respectively after removing GSLs.<sup>2</sup> As a result, Quantonomics' reference to AusNet and Powercor's large differences in opex inputs should be removed as it is only correct under some very strict assumptions, including parts of the current benchmarking framework (capitalisation) that are under review by the AER. Additionally, we have been unable to verify Quantonomics' claim given there are complexities and nuances to arrive at the exact numbers e.g., Quantonomics deflates opex by a composite labour, materials and services price index, and would appreciate a follow up with Quantonomics directly on its assumptions.

We have also included 2006's opex in the chart below which highlights that it was an unusual year. Any comparison to 2006's opex should be made with caution as its unusualness could overstate or understate results.

<sup>1</sup> Quantonomics 2022, Economic Benchmarking Results for the Australian Energy Regulator's 2022 DNSP Annual Benchmarking Report, Report prepared for Australian Energy Regulator, 3 October, p. 10.

<sup>2</sup> Based on reported data in the RINs instead of Quantonomics' approach where opex is deflated by a composite labour, materials, and services price index.



In addition to GSLs there are other aspects of opex included in the above analysis that are impacted by factors outside of our control, including:

- Bushfire recovery costs (for the 2019-20 bushfires); and
- Bushfire liability insurance premium costs: while these are not publicly reported, we understand our insurance premiums are materially higher than other networks due to our relatively high bushfire risk.

This submission does not contain any confidential information and we are happy for it to be made publicly available. Please contact Angella Nhan [REDACTED] with any questions in relation to this submission.

Sincerely,

Charlotte Eddy  
 General Manager – Regulation (Distribution)  
**AusNet Services**