

22 August 2014

Andrew Ley/Mark McLeish  
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Dear Andrew and Mark,

AusNet Services appreciates this opportunity to respond to the AER's draft analysis for the first annual benchmarking report for distribution.

Acknowledging that this is the first round of analysis and we would expect techniques to be refined over time, AusNet Services sees the analysis and results as broadly sensible. This response is focused on the three questions highlighted in the AER email dated 5 August 2014.

It is noted that the results of MTFP are highly sensitive to model specification. This should have clear implications for how the results are interpreted and applied. Specifically, it is clear that MTFP is not a precise tool, and is better suited to high-level observations than it is to making fine adjustments to estimating efficient expenditure forecasts.

Under many of the modelling specifications tested, productivity has been either stagnant or falling across the NEM. Although these results will require further assessment, some preliminary observations that may explain the pattern include: the decline in energy and slowing growth in peak demand has been an exogenous factor that has limited output growth; and, in Victoria, productivity gains post-privatisation (prior to the period covered by the analysis) were significant.

**Model specification:**

Economic Insights has recommended a modelling specification for multilateral total productivity analysis (MTFP) as the preferred model to base reporting for the AER's annual benchmarking report.

The key question in MTFP appears to be defining what outputs of distribution network services are valued. This is not a straightforward question, and indeed, the answer may be one that changes over time. AusNet Services agrees with Economic Insights view that the preferred model appears to be less biased toward either rural or urban DBs or based on network scale than other models and is therefore likely to be more robust.

Nevertheless, it is appropriate to test and account for a range of model specifications, particularly for network output, as well as referencing other types of benchmarking analysis, to ensure the interpretation of results is robust.

The nature of the tool is that not all attributes of network services can be included in the output measure. One such area that is not incorporated in any of the model specifications tested by Economic Insights is safety expenditure. As AusNet Services has invested significantly in programs that are focused on maintaining and improving the safety characteristics of the distribution network, this is one clear source of the negative productivity trend observed on the network (inputs are being directed to an output that is not measured).

**Data issues**

AusNet Services has not identified any further data issues at this stage of the process. Nevertheless, it is expected that matters of comparability of data will only be revealed as attempts to understand and explain the results are made.

**Value of customer reliability**

This issue is a further illustration of the subjective aspects of determining the value of distribution network outputs. AusNet Services recommends that the best approach is to take account of a broad range of specifications, as well as other benchmarks, and to assess whether a consistent assessment emerges.

If you wish discuss any further matters in relation to the economic benchmarking analysis, or this letter, please contact Katie Yates, Principle Economist (ph.9695 6622)

Sincerely,

A handwritten signature in black ink, appearing to read 'Tom Hallam', written in a cursive style.

Tom Hallam  
Manager Economic Regulation  
**AusNet Services**