11 October 2017

Mr Tony Weir
Assistant Director, Networks
Australian Energy Regulator
GPO Box 520
Melbourne  VIC  3001

Dear Mr Weir

**Re: Annual Benchmarking Report 2017, Electricity distribution network service providers**

AusNet Electricity Services Pty Ltd (**AusNet Services**) is pleased to have the opportunity to provide a submission on the draft 2017 annual benchmarking report for electricity distribution network service providers. This report incorporates calendar year 2016 data provided to the Australian Energy Regulator (**AER**) by AusNet Services.

AusNet Services remains supportive of benchmarking as a useful indicator of productivity trends in the individual networks. This can play a valuable investigative role in regulatory decision making as well as inform stakeholders of how a particular network's productivity changes over time.

AusNet Services notes that it is targeting top-quartile performance for its electricity distribution business by the 2020 financial year. AusNet Services has implemented a program to improve productivity and efficiency and realised $47m of efficiency benefits (capex and opex) across the business in the financial year ending March 2017. Importantly, during 2016 there were a number of one-off items that impacted electricity distribution costs during the year, in particular:

- Unusually adverse weather throughout October including a significant storm on 9 October, resulting in high GSL payments – $9.9m (nominal)

- Redundancy costs – $4.7m (nominal)

In addition to the financial costs, the October storms also impacted the reliability output measures used in the MTFP model. As such, the declining productivity identified by the AER is unsurprising. Analysis performed by AusNet Services demonstrates that, without these particular items, AusNet Services' OPFP results would have improved in 2016.

AusNet Services endeavours to achieve productivity improvements over time. Due to the efficiency program mentioned above, AusNet Services expects to see improvements in its benchmarking results in the AER's 2018 benchmarking report, and expects this improving trend to continue for the remainder of this regulatory period.

AusNet Services' submissions to previous benchmarking reports have highlighted the need to continually refine the benchmarking models to ensure they are robust and produce results that, to the extent possible, are truly reflective of the relative efficiency and productivity of networks. While defining appropriate inputs and outputs is challenging, it is appropriate to review model design every few years to extract increasingly meaningful results over time.

For the 2017 benchmarking report the AER has included an additional year of data, but has not re-formulated the benchmarking models. Accordingly, our attached submission re-iterates that we consider that community safety outcomes are not properly accounted for in the benchmarking models, which is an issue that we have previously raised.

This is particularly relevant for AusNet Services where considerable capex and opex has been spent to improve (and not just maintain) network safety. Safety outcomes have improved markedly as a result, an output of considerable value to the community but not reflected in the measured outputs. The AER's analysis leaves customers and stakeholders with the understandable but misleading impression that little of value has been generated by AusNet Services' higher expenditure.

Finally, we have provided more accurate data to ensure that redundancy costs can be fully accounted for.

We would be pleased to discuss this submission with you in more detail. Please feel free to contact Michael Larkin on (03) 9695 6346 or michael.larkin@ausnetservices.com.au should you have any questions.

Sincerely,

Tom Hallam
General Manager, Regulation and Network Strategy
**AusNet Services**

**AusNet Services' Submission on the 2017 Distribution Benchmarking Report**

**1.  Summary**

Benchmarking results are highly sensitive to model specification and operating environment factors. As such, productivity benchmarking is not a precise tool, and is better suited to providing trends and high-level observations than it is to being used deterministically. It is also important to consider the results of alternative benchmarking techniques in interpreting benchmarked performance.

AusNet Services' submissions to prior years benchmarking reports discussed the need to refine the benchmarking models to ensure they are robust and produce results that, to the extent possible, are truly reflective of the relative efficiency and productivity of networks. This submission re-iterates a key refinement that should be dealt with through detailed reviews of the distribution benchmarking models.

**2.  Community safety as a distribution output**

Since 2010, bushfire safety legislative requirements have led AusNet Services to invest heavily in reducing the risk of bushfire ignition. This has driven growth in both the asset base and operating expenditure (e.g. vegetation management). The impact of safety expenditure on AusNet Services' productivity trend has been material. In AusNet Services' 2016-20 regulatory proposal, we presented analysis that demonstrated the significant impact safety expenditure had on our MTFP results. AusNet Services is subject to continuing obligations to invest in improving safety outcomes and this will continue to negatively impact performance under a benchmarking model which does not recognise the outputs of that investment. This will contribute to an emerging gap between AusNet Services (which is improving the safety of its network) and DNSPs who have maintained the safety of their networks.

For example, AusNet Services expects to spend over $240 million ($real, 2015) installing Rapid Earth Fault Current Limiters (REFCLs) at 22 zone sub stations. This program is mandated by the Victorian Government and AusNet Services faces significant penalties if it fails to achieve the required performance standards by the required date. Installation of REFCL technology will minimise the risk of fire ignition associated with phase to ground faults on days of heightened fire danger, such as those experienced on Ash Wednesday and Black Saturday. Based upon a sample period of network fault data, analysis undertaken by the Victorian Government and CSIRO predict network fire related incidents associated with the nominated zone substations may be reduced by between 50-55%.

The REFCL program will significantly improve community safety outcomes in Victoria. However, the improved safety outcomes arising from the REFCL program will not be reflected as outputs in the AER's current MTFP model, though the program will materially increase inputs. Specifically, the delivery of the REFCL program will lead to RAB growth, increasing the cost of capital input, as well as increased physical capital inputs (e.g. additional feeders required at some REFCL sites). Further, additional networking planning, delivery and operational resources will also be required during the REFL deployment, driving increased operating expenditure.

These changes will (all else equal) lead to deterioration in AusNet Services' productivity relative to its peers that are not subject to similar safety obligations. While DNSPs in other jurisdictions may be subject to legislative obligations that require safety-driven expenditure, AusNet Services considers the Victorian bushfire safety obligations set out above are particularly material.

AusNet Services has previously highlighted the need to include community safety as an output in the benchmarking model specifications. Economic Insights have acknowledged that this position has merit and previously stated that:

> *We recognise the importance of public safety as an output for DNSPs. But we also recognise the challenges in developing a consistent and meaningful way of forming and measuring a safety output for all included DNSPs. This would be a useful topic for consultation with DNSPs in the AER's forthcoming review of the economic benchmarking data and methodology.[1]*

And

> *AusNet Distribution advocated the inclusion of an output measuring network safety as safety requirements can drive some parts of network expenditure. While the inclusion of such an output has merit, its development is beyond the currently available time available.[2]*

AusNet Service reiterates that improved safety, or reduced safety risk, should be included as an output in the MTFP model. A possible approach previously suggested by AusNet Services was to use annual F-factor data currently reported by the Victorian DNSPs. This would require consistent data to be collected from other DNSPs. As it could take time for this, or an alternative data source, to be collated and reported by DNSPs, an early review of the benchmarking model is desirable.

While we recognise the difficulties in formulating such an approach, AusNet Services would welcome the opportunity to assist the AER with refining the distribution benchmarking models so that safety outcomes are reflected in the measured outputs.

## 3. AusNet Services performance without one-off expenditure and events

We have performed some analysis to examine our benchmarking results in the absence of one-off expenditure and unusual events.

The October 2016 storms impacted AusNet Services' benchmarking results both through the GSL costs incurred as well as the poor reliability output measure used in the benchmarking models. Severely adverse weather throughout October (not including the 9 October storm which is excluded as a Major Event Day) resulted in the highest monthly USAIDI in AusNet Services' history. Additionally, the 9 October storm resulted in a $9.9 million GSL penalty which was included in network services opex.

Our analysis:

- Removes the GSL payment associated with the 9 October (MED) storm.

- Adjusts the reliability output to remove the impact of the highly anomalous (never before seen) October USAIDI.

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[1] Economic Insights, Memorandum, DNSP Economic Benchmarking Results for AER Benchmarking Report, 4 November 2016.

[2] Economic Insights, Memorandum, DNSP MTFP and Opex Cost Function Results, 13 November 2015

- Adjusts opex to remove redundancy payments. As noted by the AER, in the year redundancy costs are expensed, a DNSP's opex increases and their MTFP and OPFP decrease. In the following years you would expect a productivity increase.

This analysis shows that with these impacts removed AusNet Services' MTFP result would have remained flat in 2016 rather than declined and that AusNet Services' OPFP would have improved, rather than declined.

AusNet Services is not suggesting that the AER should make these adjustments in its benchmarking report, or that other DNSPs would not have also incurred one-off expenditures or events. This analysis is presented to explain why our 2016 benchmarking results are poor, relative to our 2015 results. Without the impact of these one-off costs and given the program of efficiency improvements we expect our benchmarking results to improve from 2017 onwards.

**Figure 1        Multilateral Total Factor Productivity**
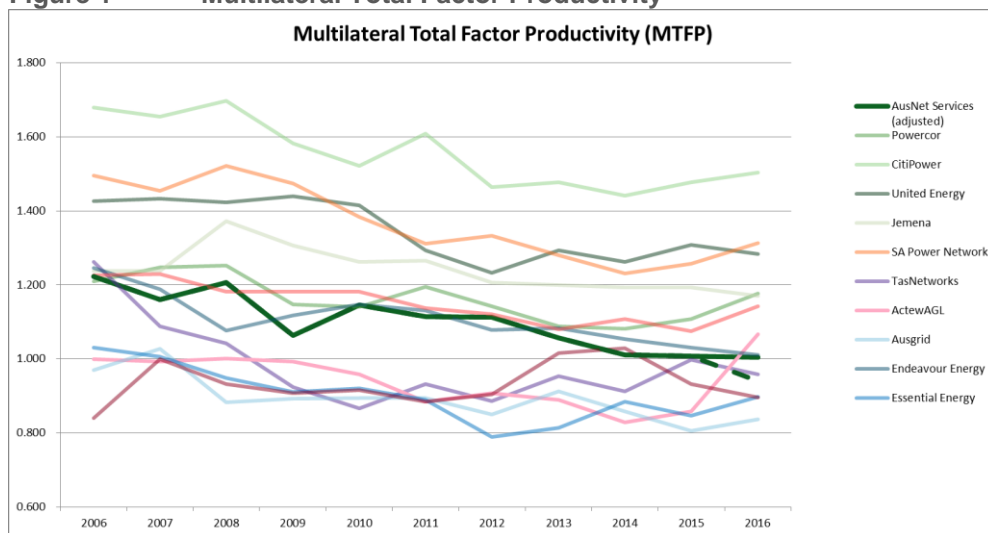


**Source: AusNet Services**

**Figure 2        Opex Partial Factor Productivity**
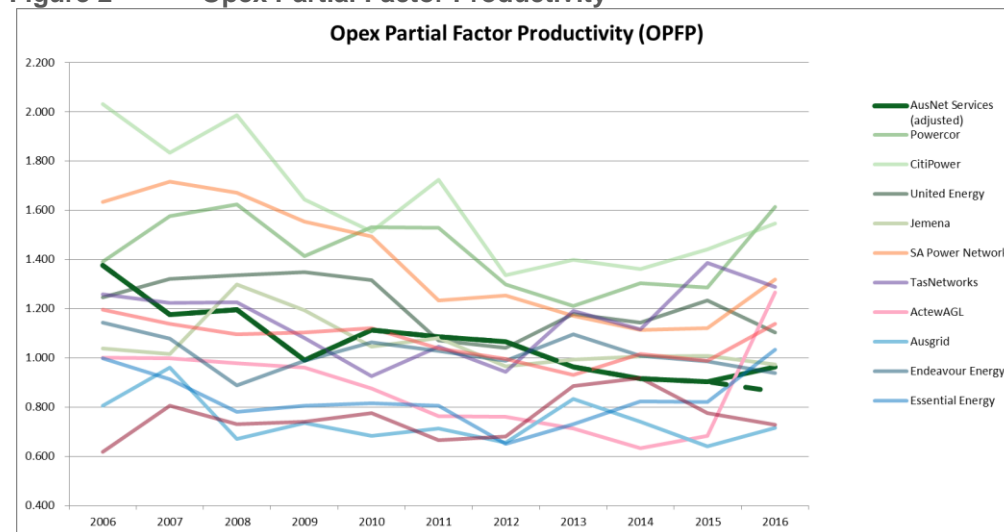


**Source: AusNet Services**

## 4.   Data Issue – Redundancy

Redundancy costs were provided to the AER as part of a separate information request. The information provided by AusNet Services incorrectly excluded the redundancy costs on an opex project relating to an organisational restructure. These additional redundancy costs (incurred in 2016) were not reported to the AER in the separate information request or included in the AER's analysis. A revised submission is included with this submission to enable the AER to incorporate the full amount of redundancy payments in their analysis. This should increase the 2016 redundancy costs used in the AER's analysis from $1.3m (nominal) to $4.7 m (nominal).