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Mr Hamish McKinnon
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Dear Hamish

Thank you for the opportunity to provide feedback on the Australian Energy Regulator's (AER) draft 2022 Benchmarking Report.

We agree with the key areas identified by the AER for ongoing incremental improvement to the benchmarking dataset and methods, particularly improving the reliability performance of the Translog econometric opex cost function models. The Translog econometric models for Ausgrid for the short period have not passed the monotonicity requirement over the last three years. We continue to be concerned with the comparability of average efficiency over time and across DNSPs, when these are based on varying numbers of econometric models depending on whether they meet the monotonicity property. We are also particularly concerned this close to our regulatory reset because the inclusion or exclusion of certain models due to monotonicity can have a material impact on the calculation of efficient base year opex.

We appreciate the work by Quantonomics and the AER this year to further explore the potential suitability of alternative hybrid forms of the econometric model to address monotonicity. However, we note that there are no conclusive outcomes from this work to date, and that further testing will be required to potentially replace the Translog models with the hybrid models. We also consider that the longer-term performance of the hybrid models and consistency of the efficiency scores with the current Cobb-Douglas and Translog models need to be addressed. While we are unable to comment in detail on the specification of the models and the analysis within the short time we have had access to the report, we look forward to future consultation should the development work reveal an appropriate alternative to the current models.

We continue to advocate for a broader "health check" of the benchmarking framework, which would cover the identified areas for improvement, the specific issues for investigation including accounting for capitalisation differences and export services, and the application of post-benchmarking OEF adjustments. This could be achieved by the AER engaging an external benchmarking expert to undertake a one-off review of the framework. We believe an overall review, instead of ad-hoc incremental adjustments, would ensure all development areas are considered within the wider benchmarking context. This would also reduce the submission burden on stakeholders, and help ensure that all interactions for each component are considered.

In the absence of a benchmarking health check, we consider that the current benchmarking comparison efficiency score of 0.75 continues to be appropriate. Given the AER's continuing work to refine benchmarking and OEF data, the limitations of models with respect to output and input specifications, the performance of the Translog econometric models and identified development work, we agree that it is appropriate for the AER to continue to apply a conservative benchmarking comparison point.

Regarding the transition from calendar to financial year for the Victorian DNSPs, we note that the AER has adopted its preferred approach of using both calendar year data (2006-2020) and financial year data (2021) for the Victorian DNSPs. We trust the AER's analysis that using the 2020 calendar year and 2021 financial year data did not exert a material impact on the benchmarking modelling. We are happy to support this simple approach as we recognise the data quality and auditability issues associated with using historical recast financial year data.

However, in comparing the productivity growth rates among DNSPs over FY21, the AER doubled the growth rate for the Victorian DNSPs to calculate an annualised rate because the difference between 2020 and 2021 for Victorian DNSPs represents only a six-month period. By doing this, it is assumed that the growth observed over the six-month overlap period also occurred over the previous six months. We note that another equally valid way to estimate an annualised growth rate would be to calculate the growth rate over the 18-month period from 1 January 2020 to 30 June 2021 and then divide by 1.5. This alternative calculation would result in different growth rate estimates.

This suggests that the estimated growth rates the AER is reporting may be due in large part to the simplifying assumption the AER has taken to calculate the growth rate. The most appropriate approach is to calculate the growth rates for the Victorian DNSPs over FY21 in the same way it is calculated for the other DNSPs, by using restated inputs and outputs over FY20 on a financial year basis. In the absence of recast historical data, we would suggest that the AER acknowledge in the report that there are alternative ways to estimate the growth rates and report these in a footnote in the report. This will make it clear to readers that the comparative performance of DNSPs over FY21 may be different depending on the estimation approach taken.

Regards,

Alex McPherson
Head of Regulation