

14 October 2016

Ms Paula Conboy
Chair
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Dear Ms Conboy

RE: AER's Draft 2016 Annual Benchmarking Report

Endeavour Energy appreciates the opportunity to provide comments on the AER's Draft 2016 Annual Benchmarking Report (the draft report or ABR).

Endeavour Energy considers benchmarking can be a valuable tool in reviewing the relative performance of network businesses. We note the challenges of benchmarking given the heterogeneous nature of Distribution Network Service Providers (DNSPs) in Australia and adequately accounting for the varied operating environments across the National Electricity Market (NEM). We therefore consider the ABR should be used to not only present the latest benchmarking results, but to also test the validity and robustness of the models, data quality and methodologies used and to identify areas for review and improvement.

We do not consider the models currently used by the AER are the more robust available and consider the benchmarking techniques poor in comparison to the tools and approaches used by international regulators. Following the findings of the Australian Competition Tribunal (Tribunal) on the AER's 2014-19 NSW/ACT determination, it is concerning that the draft ABR is mostly unchanged from previous versions and is without discussion, scenario testing or analysis of whether the models and data could be improved, replaced or complemented by alternate methods or calibrations. Developing a dataset and benchmarking approach that is of sufficient quality that it may reliably inform stakeholders of the relative efficiency of DNSPs should be an iterative and ongoing process.

We note that Endeavour Energy's productivity performance, according to the Multilateral Total Factor Productivity (MTFP) measure, has declined between 2013-14 and 2014-15. We also note that our average MTFP rank over the 2006-15 period continues to improve. The decline in the most recent 12 months is counter-intuitive based on the significant efficiency improvements we have made over the last several years. We therefore reviewed the data provided and discovered that the change in our MTFP score is simply driven by a single capital input, specifically circuit capacity (MVA) per underground distribution circuit length (km).

The Benchmarking Regulatory Information Notice (RIN) requires that the weighted average capacities reported in tables 3.5.1.3-4 are reflective of the limits imposed by thermal and voltage drop considerations¹. Endeavour Energy, along with the majority of DNSPs, prepared the data in accordance with this requirement over the 2005-06 to 2013-14 years. However, the information provided in our 2014-15 RIN did not de-rate the distribution capacities reported in cells DPA0405 and DPA0408 to reflect normal circumstances as required. We attach an updated 2014-15 Benchmarking RIN with the corrected data. This resolves the fluctuation in Endeavour Energy's MTFP score. We expect this adjustment will change our average MTFP score from 1.192 to 1.213 and change our 2015 MTFP score from 1.06 to 1.10. These changes may therefore also impact our ranking.

Setting this issue aside, we have also identified a number of other concerns with the AER's draft report, all of which have been raised in our submissions on previous ABRs:

- **Consultation:** insufficient time has been provided to conduct any detailed and meaningful error checking or analysis. The feedback provided by DNSPs to date has not been

¹ AER, Economic Benchmarking RIN for distribution network service providers – Instructions and Definitions, November 2013, p. 33

incorporated with little change in the AER's approach since the 2014 ABR. We recommend the ABR be used as an annual opportunity to refine existing techniques and data requirements and to test alternate models, specifications and adjustment factors;

- **Use of partial and multi factor productivity measures:** the ABR predominately relies on Partial Performance Indicators (PPIs), MTFP and Multilateral Partial Factor Productivity (MPFP) measures to assess the efficiency and productivity of DNSPs. These measures are not fit for purpose because they cannot account for the many differences in operating environments and scale between entities;
- **Use of econometric techniques:** the draft report provides econometric modelling results, including the AER's primary Cobb-Douglas Stochastic Frontier Analysis (SFA) model. We recommend the AER clarify whether this model remains the AER's preferred tool and to acknowledge and address the findings of the Tribunal;
- **Averaging period:** the ABR continues to benchmark providers over more than the most recent 12 month period. Whilst measures over time may assist in identifying performance trends and smoothing fluctuations, historical information may lack relevance and conceal a DNSPs most recent performance. We recommend the most recent 12 month period should be the focus, as per the Rules, with a five year rolling average provided as auxiliary information; and
- **Conclusions:** there continues to be conclusions about the relative efficiency of DNSPs that are unsupportable or unreasonable in the circumstances:
 - there has been no proper consideration of the operating environment factors which impact the results or proper adjustment of underlying data to enable a more like for like comparison between DNSPs;
 - little recognition and weight has been applied to each DNSPs predominant cost drivers; and
 - the ratio of inputs and outputs used in the modelling is not disclosed in the report. Nor has the rationale for their use and respective weightings;

These matters are addressed in further detail in Attachment A to this response.

We consider that in its current form, the report does not serve its full purpose in informing stakeholders of the AER's intended approach in a consultative way. The National Electricity Objective will best be achieved by a transparent and ongoing process to understand and refine the available tools in order to minimise the risk of regulatory error and provide stakeholders with reliable and accurate information.

At this stage, we recommend the measures in the draft report are presented without judgements as to the relative efficiency of DNSPs as they do not support such conclusions and may mislead stakeholders. Instead the report should simply qualify the accuracy and reliability of the measures presented and present the alternative view of the results and allow stakeholders to form their own views. If the AER wishes to include a view as to the relative efficiency of DNSPs then more time and effort must be spent on ensuring the data is more accurate and comparable across DNSPs. Furthermore, any results should be further analysed and interrogated to understand whether the results are driven by the operational and environmental differences between DNSPs.

If you would like to discuss this response further please contact Jon Hocking, Manager Regulation at Endeavour Energy on (02) 9853 4386 or via email at jon.hocking@endeavourenergy.com.au.

Yours sincerely



David Neville
Acting Chief Executive Officer
Endeavour Energy

Attachment A: Detailed response to AER's Draft Annual Benchmarking Report

Appropriate consultation

Given the limited time provided for responding to the draft ABR, we have not been afforded sufficient time to review the extensive data provided for errors, anomalies, areas for further investigation or to propose alternate approaches. As such, we recommend that the AER conduct detailed independent data checking to ensure the report is at least based on error free data.

In the absence of more detailed commentary, we note that Endeavour Energy has provided extensive commentary on the AER's approach to benchmarking during the Better Regulation consultation process, the NSW/ACT 2014-19 distribution determinations and in response to previous ABRs. This material includes numerous expert reports reviewing the AER's dataset, methodologies and application of benchmarking in detail. We refer the AER to this substantive body of material provided to date which provides advice as to how the AER can refine its approach over time.

More importantly, we also recommend that the AER audit the data provided to understand whether there is a consistent application of the AER's guidelines and instructions. Whilst DNSPs provide audited data there are numerous, legitimate approaches to classifying and accounting for categories of costs and complying with the AER's instructions. The AER should seek to understand whether the application of each DNSPs' respective Cost Allocation Methodology (CAM), various capitalisation policies and estimation methods result in material differences in the data. These issues need to be addressed over time to ensure that any benchmarking conducted relies on data that has been prepared on a consistent basis.

Given the complexities involved in benchmarking network businesses in Australia, Endeavour Energy is of the view that the AER should adopt an approach that recognises that benchmarking has typically been developed and refined by regulators in overseas jurisdictions on an ongoing incremental basis. In particular the AER should view its draft report as an opportunity to continue the process of due diligence on the benchmarking that it is undertaking. This requires an approach that encourages constructive criticism of the methodology and data the AER has included in its draft ABR.

To date, there has been little change or evolution of the AER's benchmarking approach in spite of the feedback provided by DNSPs and Tribunal findings. Instead, the AER considers its existing models are the "most robust measures of overall efficiency available"². We do not support this view as:

- there is no objective statistical or scientific means of testing this position, particularly as no statistical information is provided by those techniques;
- there is significant variability in results produced by alternate specifications;
- no other regulator in the world uses the same input and out specification relied upon by the AER; and
- there are demonstrably superior econometric models from a statistical basis that have been presented to the AER during regulatory determinations.

In light of this we would recommend that the AER reconsider its position and instead publish its draft ABR, along with a detailed methodology of its calculations, and highlight any areas where it considers further investigation is required (for example measures that have produced particularly divergent results or the development of pre-modelling adjustments for environmental factors).

We would welcome the opportunity to participate in recurrent, regular workshops to help develop the AER's dataset and benchmarking methodology and to better understand the results. The AER could complement this with further written consultation to allow all stakeholders to respond to the issues raised in the workshops.

Inappropriate Averaging period

Endeavour Energy notes that clause 6.27 of the Rules requires the AER to publish a report which describes the relative efficiency of DNSPs over a **12 month period**. Whilst the report contains the results of 2015-16, the report is more heavily focussed on average periods from 2010-15 or 2006-15.

For reasons which have been set out in detail in Endeavour Energy's submissions to the AER, the use of an averaging period dating back to 2005-06 has the potential to conceal the current performance of a business. This is particularly apparent in circumstances where, during the relevant period, some businesses have improved their operating performance, while other businesses have increased their costs for compliance or other reasons.

² AER, Draft Annual Benchmarking Report – Electricity distribution network service providers, September 2016, p. 5

It is unclear why, if an averaging period is to be presented, a rolling average is not used instead. The initial eight year averaging period has now extended to ten years. It was our understanding that the initial averaging period was eight years simply to ensure the econometric models had enough data to function. We consider the requirements of a particular model should not guide the averaging period adopted. Instead, the most relevant benchmarking information should be presented to stakeholders.

This issue was obviously contemplated by the AEMC as part of the Better Regulation consultation process and the outcome was a requirement to benchmark DNSPs on the most recent 12 month period. We support this as historical data becomes less reflective of current circumstances over time and therefore of less relevance in assessing current performance.

Furthermore, there is ample evidence to suggest that the historical data is not reflective of efficient levels of expenditure meaning it should at least be adjusted or preferably excluded from the AER's benchmarking exercise. For instance, the AER note the declining productivity of the Victorian DNSPs over the 2008-14 period despite many being considered the "best" performers amongst DNSPs. The AER attribute this declining productivity to the more stringent clearance requirements imposed under the *Electricity Safety (Electric Line Clearance) Regulations 2010* following the Black Saturday Bushfires and, without substantiation, heavy rainfall during the period.

The AER considers these drivers will not contribute to further productivity declines based on the Victorian DNSPs improved performance in 2015. It is not explained or evident whether the improved productivity performance is attributable to a reduction in vegetation management expenditure between 2014 and 2015. If it was, it would suggest that these costs were a one-off increase in costs that should be removed from the dataset as expenditure is returning to "efficient" pre-2010 levels. Obviously this would not be appropriate as the increase in vegetation management expenditure appears to be permanent and the 2015 expenditure still represents an increase relative to 2009. Rather, it would seem that for the majority of the averaging period the Victorian DNSPs vegetation expenditure was inadequate, an observation supported by the Victorian Bushfires Royal Commission and Tribunal. In our view, this provides further evidence and justification for departing from the current, ever-expanding averaging period and instead relying on more recent performance.

Content of the ABR

Econometric techniques

In its final position paper for the 2012 Economic Regulation of Network Service Providers Rule change, the AEMC stated that the ABR is one of a number of provisions designed to improve the ability of consumers to participate in the regulatory determination process.³

Endeavour Energy notes that econometric modelling results, including the AER's Cobb-Douglas SFA model, are contained in the report. However, this is confined to Figure 8 of the draft report which compares average econometric modelling and opex MPFP results over the 2006-15 period. The PPI, MTFP and MPFP models are the primary focus of the draft report. The draft report is silent on the findings of the Tribunal on the AER's benchmarking approach and the primary method it intends to use in future determinations.

As the Rules state that the AER must have regard to the most recent ABR as part of the determination process, we believe the ABR should reflect the models and approaches that the AER intends to rely upon as part of its distribution determinations. Otherwise, the report does not serve its full purpose in informing stakeholders of the AER's intended approach and it inhibits the extent to which stakeholders can participate in the regulatory process. If the future direction is unclear there should at least be a transparent discussion of the available options and the AER's preliminary views.

The absence of any meaningful mention of econometric benchmarking techniques in the ABR can only serve to confuse stakeholders and the public. Endeavour Energy has several questions it considers should be addressed in the ABR as there is currently no clear future direction of how econometric benchmarking will be utilised in the future. Specifically:

- Has the SFA model relied upon by the AER in recent regulatory determinations been abandoned?
- If not, how will the SFA model be amended to reflect the findings of the Tribunal?
- Will data from Ontario continue to be utilised despite the fact the dataset has not been added to since 2012, thus raising doubts about its relevance?
- Does the AER propose to rely upon econometric benchmarking techniques of any kind in future determinations?

³ AEMC, Rule Determination: National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2012, 29 November 2012, pp 25-26

Productivity Indices

The ABR continues to primarily rely on MTFP, MPFP and PPI measures to compare the performance and efficiency of DNSPs. We have previously raised concerns with the MTFP and MPFP measures relied upon by the AER. Specifically, the selection of inputs and outputs for an MTFP model to measure efficiency across the diverse group of Australian DNSPs will favour some providers and induce bias against others.

Huegin⁴ has noted the significant disadvantages of MTFP, including that:

- MTFP does not take into account environmental variables, making it difficult to distinguish between inefficiency and the result of different operating environments;
- MTFP does not take into account economies of scale, making it difficult to distinguish between inefficiency and the result of scale differences;
- MTFP scores can change significantly depending on the choice of inputs and outputs; and
- MTFP does not produce any statistical results which makes it difficult to determine if the results are valid.

The chosen outputs and inputs used for MTFP purposes⁵ and their respective weightings were arbitrarily selected and set at the time the AER originally developed these tools. The selection was on the basis of a relatively subjective assessment of their validity based on the results they produced rather than a scientific approach to testing and selecting the model specifications.

It has since been demonstrated that alternate specifications can significantly impact the results of the MTFP. There is little explanation of why the MTFP specification was and continues to be considered appropriate. The Economic Insights attachment referred to in the ABR simply lists the specification used.

Indeed, similar to the EI SFA models, MTFP and MPFP measures can produce materially different results through minor adjustments to the inputs measured or the weighting of these inputs. This suggests a level of subjectivity in the model specification that must be addressed through using multiple models, or treated with an appropriate level of caution. We consider the continued industry trend of declining productivity and convergence of “most” and “least” productive DNSPs should be cause for concern. Rather than being an accurate reflection of the performance of DNSPs it may be evidence of model misspecification. We consider this is likely to be the case because:

- the assumption that any increase in opex and/or the quantity and rating of physical assets should correspond with a proportionate increase in energy throughput, customer numbers, ratcheted peak demand, circuit length and/or decrease in customer minutes off supply has not been established and is questionable;
- the physical assets currently installed in each network is the product of several decades and largely outside of management’s control;
- the customer numbers, demand and consumption are largely organic;
- reliability is largely inherent to the network design legacy, location and environment; and
- capex is not included in the model specification and the capitalisation of opex does not impact the capital stock variables included in the model. This means the capex-opex trade-off is not considered and higher levels of capitalisation result in artificial “efficiency gains”.

It appears the AER does not consider these issues to be material. Rather than test alternate models and specifications the AER are comforted by the apparent convergence in the results between the existing productivity indices and econometric techniques⁶. We disagree with this view as any convergence in results may be due to the models being infected by biases (as listed above), errors and data limitations.

We recommend more robust consideration be given to the selection of the input and output specifications and transparency as to the statistical and qualitative criteria used to select the preferred specification. We consider that assumptions used to select a specification should be explained in further detail and alternate specifications should be included and examined. Otherwise the results produced by the models will continue to be questionable and of little value.

⁴ Huegin, Response to draft determination on behalf of NNSW and ActewAGL - Technical response to the application of benchmarking by the AER, January 2015, p. 12.

⁵ Outputs: Energy throughput, ratcheted maximum demand, customer numbers, circuit length and minutes off-supply. Inputs: opex, overhead subtransmission lines, overhead distribution lines, underground subtransmission cables, underground distribution cables and transformers and other capital.

⁶ AER, Draft Annual Benchmarking Report – Electricity distribution network service providers, September 2016, p. 18

The draft report also contains and relies on PPIs in comparing the performance and efficiency of DNSPs. Endeavour Energy has previously raised concerns in relation to the use of productivity indexes. For example, Pacific Economics Group considered productivity indexes in detail and explained that⁷:

Productivity indexes are more accurate than unit cost indexes as benchmarking tools because they control for differences between utilities in input prices as well as operating scale. They nonetheless have major limitations as benchmarking tools. Like unit cost indexes, they do not control for differences in the opportunity of utilities to realize scale economies. Neither do they control for differences between companies in the values of Z variables. It follows that the selection of a similar peer group is of great importance to the accuracy of a benchmarking study based on productivity indexes. Once again, it is desirable for there to be numerous similarly situated peers.

The AER acknowledges these limitations⁸. However, despite these acknowledgements, PPIs are used in a manner that belies an awareness of both the nature of PPIs and their limitations⁹.

Under this measure, the Victorian and South Australian DNSPs perform the best in their combined use of opex and assets. They have the lowest ratio of cost to customers, despite their differing customer densities, of between approximately \$400 and \$800 per customer.

Firstly, a virtually straight line can be drawn from South Australia Power Networks to CitiPower. If South Australian and Victorian DNSPs are considered the best it would suggest that customer density (per km) has little to no influence over the total cost per customer. More importantly, this use of PPIs is contrary to previous comments by the AER and AEMC as to their reliability¹⁰:

...we consider that PPIs do not, on their own, adequately measure relative efficiency. In order to measure relative efficiency it is necessary to consider the multiple inputs and outputs of networks, their scale and the environment within which they operate. As stated in the ACCC/AER working paper series on benchmarking opex and capex in electricity networks:

- *While PPIs provide some insights, they can give misleading information regarding the overall economic performance of energy utilities producing multiple outputs and multiple inputs. ...*

...PPIs assume a linear relationship between the input and output measures and also assume that any change in the input measure can be described by a change in the output measure. However, in most circumstances the change in an input usage will be dependent on a number of inputs, outputs and other factors that may not be described in the model.... Because of this, they may present problems in providing a meaningful comparison of businesses in different operating environments

It is therefore confusing for the value of PPIs to be appropriately qualified but then misused. As noted in the quote above, PPIs assume a linear relationship between the selected input and output.

By way of example, in the Figure 10 PPI the AER is assuming a relationship exists (which can be causal or correlated) between the total cost per MW of maximum demand against customer density (per km). Based on this measure the AER has formed the opinion that¹¹:

Under this measure, the Victorian DNSPs (excluding AusNet Services) perform the best in their combined use of opex and assets. They spend the least per MW of maximum demand, despite their differing customer densities. TasNetworks and Endeavour Energy spend comparable amounts to SA Power Networks. However, AusNet Services, Energex, Ausgrid and ActewAGL spend more than these DNSPs, despite having similar or higher customer densities.

An evaluative judgement such as this is a tacit expression in the confidence of both the explanatory power and causality that exists between the chosen factors. Such conclusions are inappropriate and at least premature without further interrogating the results and potential relationship. Given the complexity of networks and the multitude of factors which may impact a DNSP's costs, it is highly unlikely that any conclusion made based on a single factor PPI will be reliable or accurate. Rather, it is most likely a case of model misspecification where the relationship between the factors is under or over stated based on its inability to account for other potential key drivers.

⁷ Pacific Economics Group, Statistical Benchmarking for NSW Distributors, January 2015, pp. 21-22

⁸ AER, Draft Annual Benchmarking Report – Electricity distribution network service providers, September 2016, p. 19

⁹ AER, Draft Annual Benchmarking Report – Electricity distribution network service providers, September 2016, p. 20

¹⁰ AER, Endeavour Energy Draft Determination – Attachment 7: Operating Expenditure, November 2014, pp 49-50

¹¹ AER, Draft Annual Benchmarking Report – Electricity distribution network service providers, September 2016, p. 21

For the sake of transparency, we reiterate our request that a 'line-of-best' fit and the equation and R^2 should be included on each PPI. A line of best fit would add greater transparency and value to the PPIs and help reduce the likelihood of stakeholders misinterpreting the results. It would also provide stakeholders with an indication of the extent to which variations in the organisational (normalising) factor explain variations in the partial productivity measure. We note that the variations differ markedly depending on whether a linear or non-linear line of best fit is used, and generally the R^2 results are weak, suggesting limited explanatory value of the analysis.

This would also help initiate discussions about the value of each PPI and establish a more transparent and objective way of meaningfully comparing DNSPs. Previously, the AER have rejected this request stating a line of best fit would¹²:

...assume certain relationships between PPI inputs and outputs. We consider that including these could be misleading as any trend line will assume a certain relationship between inputs and outputs, which we have not verified. Further trend lines may not necessarily reflect the relationship between inputs and outputs, as they may be affected by outlying results and inefficient performers.

We disagree with this view as it is the practise of identifying "best" and "worst" performers without any data and model robustness checks that is misleading, unverified and potentially inaccurate. A line of best fit simply adds transparency around the implicit assumptions being made. Where there is uncertainty as to nature of the relationship, alternate lines could be displayed. Based on the AER's own rationale above no PPIs should be included in the ABR unless the AER has analysed and verified the relationship between PPI factors.

Including a PPI is setting a clear expectation that a relationship exists between the two selected factors. Ranking or assessing performance based on a PPI implicitly involves assuming an observable and significant relationship exists between the factors. Given this is contradictory to the AER's stated views on PPIs it is unclear how PPIs can continue to be included in the ABR. At the very least, we maintain our view that a line of best fit, equation and R^2 should be displayed on each PPI and no evaluative judgements are made without proper analysis and verification of any observations.

We note that alternate observations can reasonably be made based on the PPI measures relied upon by the AER. For instance, Huegin noted that, contrary to the AER's conclusion¹³:

When broken down into the primary cost categories, and using common denominators for partial productivity indicators, there is nothing to suggest that the NSW and ACT businesses are systemically overspending compared to the frontier businesses.

This supports the suggestion that further analysis and robust discussion is required before conclusions are made in reference to PPI measures.

Inappropriate conclusions

Based on the concerns raised above we continue to have significant concerns with the conclusions and observations contained in the report. The primary purpose of the report is to set out the AER's findings on the overall efficiency of each DNSP¹⁴. The reporting of comparative information is only useful to stakeholders when the comparisons are valid and reliable. The AER's approach relies on its model specifications being correct and the selected outputs being a true reflection of the absolute and relative productivity performance of DNSPs.

It is therefore concerning that the AER are relying on measures which are limited and contain bias to suggest that significant productivity gaps exist between DNSPs. The AER acknowledges these limitations in parts of the ABR, for instance¹⁵:

The rankings in this table are only indicative of the DNSPs' relative performance because there may be operating environment factors (OEFs) not captured in the MTFP model. OEFs are factors beyond a DNSP's control that can affect its costs and benchmarking performance.

In light of that acknowledgement, it is puzzling that the AER has reported the results of its benchmarking, ranked the DNSPs and drawn conclusions such as¹⁶:

In 2015, the four most productive DNSPs are CitiPower, United Energy, SA Power

¹² AER, Final Annual Benchmarking Report – Electricity distribution network service providers, November 2014, p. 47

¹³ Huegin, Response to draft determination on behalf of NNSW and ActewAGL – technical response to the application of benchmarking by the AER, January 2015, p. 57

¹⁴ AER, Draft Annual Benchmarking Report – Electricity distribution network service providers, September 2016, p. 5

¹⁵ AER, Draft Annual Benchmarking Report – Electricity distribution network service providers, September 2016, p. 15

¹⁶ AER, Draft Annual Benchmarking Report – Electricity distribution network service providers, September 2016, p. 6

Networks and Jemena and the four least productive DNSPs are Ergon Energy, ActewAGL, Essential Energy and Ausgrid. These DNSPs have consistently been among the best and worst performers, respectively, over the period.

In circumstances where the AER has not reported any quantification of the impact of OEFs we consider it is misleading and inappropriate to draw conclusions on admittedly limited productivity indices supported by flawed econometric modelling results. Endeavour Energy is particularly disadvantaged as a DNSP with a sub-transmission network. The AER's approach to mitigating this issue is ineffective and the continued use of MVA-km of line assets as input variables in the AER's MTFP model continues to discriminate against DNSPs with high voltage assets. This is exacerbated by the exponential nature of MVA rating increases with voltage increases.

As such, we request that conclusions such as that set out above be removed from the document in the absence of any attempt to quantify the impact of OEFs like sub-transmission assets. Currently, the lack of proper acknowledgement given to OEFs in the ABR or indication of how the AER plans to account for OEFs in future distribution determinations is concerning. If the AER plans to continue to account for OEFs in the manner adopted in its recent determinations (which both networks and consumer groups consider to be arbitrary), this should be clearly stated so that the AER's methodology is subject to the consultation and criticism of the ABR process.

We consider that assessing OEFs is not well suited to being done on an individual DNSP basis during the staggered determination processes as suggested by the AER¹⁷. Instead it should form a primary part of the ABR given its importance to understanding and analysing the benchmarking results presented. The ABR is of limited value without this context and critical element of the AER's application of benchmarking in determinations.

Rather than examine OEFs in a detailed and systematic manner, section three of the draft report contains some limited analysis of the results. For instance, the AER broadly states¹⁸:

As part of our ongoing benchmarking work, we intend to investigate the drivers of the declining productivity trend. In particular, we are interested in how exogenous drivers of costs affect productivity.

We are supportive of further analysis being conducted and request that further details are provided about the "ongoing work" referred to above. Ideally, its progress and/or findings should be included in the ABR to facilitate a transparent, consultative process. Our views on this matter are well documented and have been provided to the AER as part of our 2014-19 determination process.

The draft report goes on to suggest that the declining productivity amongst the Victorian DNSPs was a one-off associated with increased vegetation management expenditure following the outcomes of the Black Saturday Royal Commission and a period of heavy rainfall. As previously stated, this observed increase in opex suggests that:

- the increased vegetation management expenditure is a one-off increase and expenditure will return to pre-2010 levels. If this is the case the one-off step change should be removed from the historical data to normalise; or
- the increase vegetation management expenditure is a new baseline following the correction of historically inadequate and unsafe levels of expenditure. If this is the case the historical expenditure should be increased (i.e. normalised) to ensure the AER's benchmark does not reflect (or reinforce through determinations) a level of expenditure that is insufficient to meet the opex objectives, factors and criteria

The draft report also examines the performance of TasNetworks, which has improved to become the second "most productive" DNSP according to MPFP. The improvement is mainly attributable to a reduction in overheads following a merger with the Tasmanian transmission network service provider. We do not consider structural changes are reflective of "efficiencies". It may have been more appropriate to normalise TasNetworks opex for this structural change, similar to how the Benchmarking RIN treats changes in a DNSPs CAM.

At a cursory level the AER note¹⁹ that the NSW, QLD and ACT DNSPs continue to "benchmark poorly" although "recent cost cutting initiatives will improve their performance." For reasons outlined above, we are sceptical as to whether the measures relied upon by the AER are capturing efficiency given their known limitations, failure to account for OEFs and data issues. We consider the draft ABR would be improved by including a greater amount of DNSP specific commentary and analysis. There

¹⁷ AER, Draft Annual Benchmarking Report – Electricity distribution network service providers, September 2016, p. 27

¹⁸ AER, Draft Annual Benchmarking Report – Electricity distribution network service providers, September 2016, p. 24

¹⁹ AER, Draft Annual Benchmarking Report – Electricity distribution network service providers, September 2016, p. 26

is no clear reason why DNSPs should continue to be grouped by jurisdiction as this may mask individual performance and inhibit a fair judgement of each DNSP.

We therefore consider that in its current form, the measures in the draft report should be presented without evaluative judgements as to the relative efficiency of DNSPs as they do not support such conclusions and may mislead stakeholders.

Instead, the report could simply qualify the accuracy and reliability of the measures presented and present the alternative view of the results and allow stakeholders to form their own views as to relative efficiency. If the AER wishes to include a view as to the relative efficiency of DNSPs then more time and effort must be spent on ensuring the data is sufficiently accurate and comparable across DNSPs. Furthermore, any results should be further analysed and interrogated to understand whether the results are driven by the relative efficiency of DNSPs, the operational and environmental differences between DNSPs or a combination of both.