

15 August 2014

Mr Chris Pattas
General Manager
Network Operations and Development
Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001



Dear Mr Pattas

Energex response to AER's draft Annual Benchmarking Report

Energex Limited (Energex) welcomes the opportunity to respond to the draft Annual Benchmarking Report released by the Australian Energy Regulator (AER) on 5 August 2014.

Energex would like to recognise the significant amount of work undertaken by the AER and Network Service Providers (NSPs) to collate and validate data, develop benchmarking models and prepare the draft report.

Given the importance the AER is expected to give benchmarking when assessing regulatory proposals, it is critical that the limitations of the data and the model specification is understood, recognised and communicated.

Energex has the following observations and concerns that it requests the AER take into consideration as it finalises the report.

Consistency of data

Energex is particularly concerned with the consistency of the data used by the AER for the purposes of benchmarking.

Recent costs such as Solar Bonus Feed-in Tariffs (FiT) and one-off costs such as restructuring costs have been included in the total opex costs used by the MTFP model. These are significant, predominantly exogenous, costs for Energex that were not present in the business in 2006 and therefore (through their inclusion in later years) appear in the benchmark modelling to indicate a decline in productivity.

In particular Energex's Solar Bonus FiT costs, which arise from the application of the Electricity Act, have significantly increased over the last three years with payments of \$19.4M in 2011, \$73.9M in 2012 and \$167.1M in 2013 included in SCS Other Operating Costs (DOPEX0113) variable. This is a Queensland specific jurisdictional requirement and the inclusion of these large amounts for the purposes of benchmarking is misleading and discredits the analysis itself. Energex requests that these costs be removed from the benchmarking analysis.

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Energex is proposing to treat FiT payments under a Jurisdictional Scheme for the 2015-20 regulatory control period and hence will no longer report FiT payments as part of its opex from 1 July 2015.

Energex also wishes to highlight that even though the AER has attempted to standardise the data collection and data metrics across all DNSPs, different accounting policies, capitalisation policies, cost allocation methods, network design and ownership structures will create inconsistencies for inputs and outputs which will influence benchmarking results.

Model Specification

Model specification concerns have been raised previously during the consultation period for the AER's Expenditure Forecast Assessment Guidelines. Specifically, the selection of inputs and outputs for an MTFP model to measure efficiency across the diverse group of Australian DNSPs will always favour some and induce bias against others.

The process of selecting the appropriate model specification can be subjective and could potentially skew the efficiency results to a particular type of business that is favoured by the model construct.

The Economic Insights Memorandum on DNSP MTPF Results dated 25 July 2014 indicates that some model specifications favour 'rural' businesses and whilst some favour 'urban' businesses. It does not necessarily follow that if a particular model specification places the rural and urban businesses in relative positions that this model specification is valid or invalid. The reason that the models produce such different and inconsistent results is more likely due to the heterogeneity of the data sample.

Energex is concerned that the differences between the businesses (and not just customer density) cannot be normalised with a single model specification and suggests that multiple frontiers may exist in efficiency models of businesses operating in diverse conditions. This should be explained in the final Report.

Value of Customer Reliability (VCR)

The AER has specifically asked for feedback on the halving of the VCR in its assumptions. Given the reliability measure is in the context of past performance, Energex believes the value that applied for VCR at that time should be used.

Should you have any enquires regarding this submission please contact Nicola Roscoe, Revenue Strategy Manager – Network on (07) 3664 5891.

Yours sincerely



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Strategy, Regulation and Governance