09 October 2015

Mr Andrew Ley
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Dear Mr Ley

Energex response to the AER's draft 2015 annual benchmarking report

Energex Limited (Energex) welcomes the opportunity to respond to the draft annual benchmarking report provided by the Australian Energy Regulator (AER) on 17 September 2015.

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

Minor errors in the draft report
Energex notes the following minor errors in the draft report:

- p13 (Table 1 caption) – distribution capacity is no longer included
- p16 (Table 2) – opex for CIT, ERG, PCR does not match spreadsheet
- p16 (Table 2) – asset cost data does not match spreadsheet
- p17 – incorrect year referenced in footnote 14
- p23 – footnote missing
- p33 – Figure 27 is the same as Figure 26 (cost per customer)

One-off costs
Although solar feed in tariff costs have been excluded from opex, there are other significant one-off costs which are included in the Multilateral total factor productivity (MTFP) model. In 2012-13 Energex had substantial restructuring costs (representing approximately 13% of opex). The inclusion of these one-off costs can indicate a decline in productivity as they were not incurred in earlier years.

Consistency of data
Energex notes that the AER has attempted to standardise the data collection and data metrics across the Distribution Network Service Providers (DNSPs) through the benchmarking RINs. However, a variety of accounting policies, capitalisation policies, cost allocation methods, network design and ownership structures between DNSPs can lead to inconsistency of reported data. In addition, a portion of the 2006-2013 data was estimated or "backcast" by DNSPs when it was collected by the AER in 2014. Energex notes that over time the quality of data will improve as DNSPs put systems in place to collect actual information.

Model specification
Energex notes that the MTFP/MPFP model specification has not changed. Concerns regarding model specification have been raised previously (by a

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number of DNSPs and consultants) during the consultation period for the previous benchmarking report and the recent AER determinations. Previous analysis has outlined the variability in results when alternate model specifications are used.

The selection of inputs and outputs for the model to measure efficiency across the diverse group of Australian DNSPs will always favour some DNSPs over others. No single model may ever fit the individual circumstances of all DNSPs and the results between businesses could be driven by exogenous factors rather than inefficiency. In addition, given the heterogeneity of Australian DNSPs multiple frontiers may be required in order to measure efficiency levels.

In recent determinations the AER presented opex efficiency results using four methods, noting that the preferred results were from the Stochastic Frontier Analysis (SFA) Cobb-Douglas model. Energex notes that the 2015 draft report does not include any updated results from the SFA model. Energex suggests that the AER include commentary regarding the potential use of benchmarking models in future determinations.

Historical time period
The opex MPFP results are determined over the 2006-2014 time period, with the efficiency score calculated as the average over this period. By using a historical average over an extended period it takes considerable time for a DNSP to make increases to their efficiency score (as any recent improvements are weakened by past historical performance). In addition, this approach may also not account for DNSPs at different points in their investment cycle or businesses that have experienced significant changes in operating conditions over the time period.

Operating environment factors
Energex agrees that it is not possible to include all factors influencing a DNSP's cost in the benchmarking model. In recent determinations the AER has applied a qualitative adjustment to account for operating environment factors. Energex has a number of factors outside of its control, including for example; extreme weather and vegetation management practices impacting on opex (model input) and the significant penetration of solar PV impacting on energy throughput (model output). The impact of operating environment factors should be considered in greater detail.

Benchmarking application
Energex welcomes the approach (in recent determinations) of the conservative application of benchmarking to allow a margin for potential data, modelling issues and other uncertainties. Given we are in the early stages of benchmarking in Australia, Energex believes this approach should continue. Benchmarking should be considered as only one aspect of assessing a DNSPs efficient expenditure.

Should you have any queries regarding the comments raised above please do not hesitate to contact Mr Neil Andersen, Group Manager Regulation and Pricing on (07) 3664 4009.

Yours sincerely

Kevin Kehl
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Strategy, Regulation and Governance