

9 October 2015

Andrew Ley
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Jemena Electricity
Networks (Vic) Ltd
ABN 82 064 651 083

321 Ferntree Gully Road
Mount Waverley VIC 3149
Locked Bag 7000
Mount Waverley VIC 3149
T +61 3 8544 9000
F +61 3 8544 9888
www.jemena.com.au

Dear Mr Ley,

Consultation on draft Annual Benchmarking Report (Nov 2015)

Thank you for the opportunity to review and provide comments on the Australian Energy Regulator's (AER) latest version of the annual benchmarking report (Nov 2015) (**report**).

Jemena Electricity Networks (JEN) Ltd is supportive of benchmarking distribution network service providers (DNSP) in the national electricity market (NEM); we consider that benchmarking can provide a useful 'first pass' assessment of how well a DNSP has performed relative to its peers.

However, benchmarking measures are limited in their ability to account for factors when used as the basis to decide a DNSP's forecast of expenditure requirements; benchmarking cannot displace the primary role of the service provider's proposal. JEN's views on benchmarking are contained in our 2016-20 regulatory proposal document *Attachment 08.04 - The role of benchmarking and predictive modelling*, and is reproduced in Attachment A to this submission.

JEN has a number of concerns with the AER's report and responds with the following.

Estimated data impacts stakeholders' ability to rely on the outcomes

Since submitting its regulatory proposal, JEN has identified a number of instances where stakeholders have inferred incorrect observations from benchmarking data. JEN suggests that each of the instances could have been avoided if the AER's benchmarking report better acknowledged benchmarking constraints caused by current underlying data issues.

In a number of examples across a range of different submissions and forums, the AER (including its technical advisory group and consultant) and broader stakeholders have made incorrect observations by failing to understand issues relating to benchmark data constraints.

- The Consumer Challenge Panel (CCP) has noted concerns with asset life data as it relates to replacement capital expenditure¹. The CCP incorrectly compared asset lives of various networks using asset life data in the Economic Benchmarking RIN (EB RIN).

¹ Sub Panel CCP3, "Submission to the Australian Energy Regulator (AER), Consumer Challenge Panel Sub Panel 3 (CCP3), Response to proposals from Victorian electricity distribution network service providers for a revenue reset for the 2016-2020 regulatory period", David Headberry Beverley Hughson David Prins, 5 August 2015, page 50

JEN responded to the CCP advice² explaining how the asset lives provided in the EB RIN are based on a 'network services' regulatory asset base (RAB)³

- In the case of the AER⁴ (including its advisers and consultant), it correctly sourced estimated asset life data from category analysis RIN responses however failed to interrogate the basis on which the information was provided by various businesses— i.e. the submitted basis of preparation documents accompanying DNSPs' RIN responses. This led to material incorrect observations comparing mean asset life data across businesses.

Material issues relating to the basis of preparation of certain estimated RIN data can significantly affect benchmarking efficiency scores, therefore where estimated data is relied upon, a note must be added in the findings of the report. Left to a footnote, a reader has no ability to obtain a proper understanding of the relative performance of the distribution businesses.

Had the AER's benchmarking report noted that the benchmarks rely on estimates (only assured by an audit review—not report) and identified those instances, JEN suggests that the broader industry stakeholders would not draw incorrect conclusions as they have.

Normalising for network size and voltage is necessary

JEN believes that the AER's benchmarking analysis insufficiently normalises for network size, this comes about due to the measures employed in the modelling (i.e. relying upon customer numbers, line length, capacity etc.). For example, one of the largest network projects JEN has undertaken in recent time is its 'Preston conversion project'. This project is primarily driven by maximum demand around the Preston area exceeding the current capacity of the network in that region; JEN is replacing the 6.6kV network with a 22kV network, a best practice technical solution to address the capacity constraint and maintain current service levels. In this case, the circuit (network) length in kilometres (an output measure the MTFP analysis) and the network capacity (input measure) will both change. This change will be reflected in the benchmarking analysis as a significant increase in inputs (capacity), with a reduction in outputs (circuit length); the resulting effect on JEN's MTFP will be a material reduction in its productivity scores. As JEN is a comparatively small network, anomalies such as these are magnified in benchmarking efficiency scores.

Material anomalies in the benchmarking results like those arising from JEN's Preston conversion project should be:

- accounted for in the AER's benchmarking analysis to derive better productivity analysis
- acknowledged as due reason not to employ the results of this benchmarking in a deterministic fashion within the regulatory process.

² JEN, *Submissions to AER on CCP advice – JEN EDPR proposal*, 11 September 2015

³ A new concept derived to assess the output component of total factor productivity benchmarking on a standard scale across the NEM. In their responses to the first ever EB RIN, each of the networks in the NEM applied their own approach to estimate the asset lives for the 'network services' RAB. These approaches have been applied inconsistently across the NEM and therefore, the asset lives in the EB RIN should not be applied to conduct required replacement expenditure assessments.

⁴ See AER question #18 and #20 to JEN's 2016-20 regulatory proposal

Modelling datasets must reflect current cost allocation and service classification because that is what customers are currently paying for

The AER has not used the best dataset in its modelling. When undertaking its assessment the AER has simply rolled forward one year of data to establish a new benchmarking result in the 2014 year. This approach is erroneous as it does not reflect the changes in the regulatory or operating environment. Changes in reported historical positions occur in two key circumstances:

- Changes in cost allocation – Some distribution businesses have made material changes in their cost allocation methodologies (**CAM**). This means that the underlying data on which the benchmarking calculations are performed are misaligned with the expenditure forecasts upon which the AER must assess rule compliance and upon which future customer prices will be set. A business' CAM (and any changes to it) has an impact on a DNSP's productivity score, yet nothing has been done to normalise the differences in the historical data period even though DNSPs who materially changed their CAM have been required to submit back-cast data sets. This effectively locks businesses into whatever advantage or disadvantage their historical cost allocation methodology afforded them.

This point is also noted by the AER's consultant who states "To reduce the scope for potential gaming of both reporting and price resets, Economic Insights recommends the AER require all DNSPs to report EBRIN data on the basis of the CAMs in place for the initial EBRINs"⁵

Despite recommendations by the AER's consultant, the AER has not taken action to make corrections to their modelling.

- Changes in service classification – At each regulatory reset the AER undertakes a review of the service classifications which is reflected in the in the Framework and Approach Paper.⁶ Similar to the CAM issue above, the changes can impact the relative benchmarking performance if not reflected in the results.

To capture these changes 'back cast' Regulatory Information Notice (**RIN**) data⁷ is sought by the AER to undertake retrospective benchmarking analysis. Whilst having the more current data available the AER has neglected to utilise it in this latest round of benchmark reporting which, if used, would report a more accurate view of benchmarking performance.

The AER has or will soon be making determinations on the electricity businesses—and therefore determining prices charged to customers—based on these revised data sets. However, the annual comparative benchmark report is set on a different basis. In the interest of consistency and properly informing interested stakeholders the AER must revise its benchmark models to reflect the datasets on which it is making determinations and acknowledge where estimated data is used in its analysis. JEN believes that these issues—if left unresolved will render the AER's annual benchmarking report to be erroneous and misleading.

⁵ Economic Insights Memorandum to the 2015 Draft Annual Benchmarking Report, page 2

⁶ AER, Final Framework and approach for the Victorian Electricity Distributors Regulatory control period commencing 1 January 2016, 24 October 2014, Appendix B

⁷ For example, see submission documents: "Powercor - RIN 1.2 - Reset RIN 2016-20 - Back casting - April 2015"; "CitiPower - RIN 1.2 - Reset RIN 2016-20 - Back casting - April 2015"

If the AER wishes to discuss any aspect of this submission, we ask that you get in touch with Matthew Serpell of (03) 8544 0000.

Regards,

A handwritten signature in black ink, appearing to read 'R. McMillan', with a long horizontal flourish extending to the right.

Robert McMillan
General Manager, Regulation