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Dear Anthony

### **Consultation on draft 2017 Annual Benchmarking Report**

Jemena Electricity Networks (Vic) Ltd (**JEN**) welcomes the opportunity to comment on the Australian Energy Regulator's (**AER**) draft 2017 Annual Benchmarking Report. The report continues to provide stakeholders and distribution network service providers (**DNSPs**) with a useful view on the relative efficiencies of the DNSPs over time.

We request the AER make the following modifications to its final report:

1. The data JEN submitted on redundancy expenditure was marked confidential (see attached email). Accordingly, this should be reflected in the final report at footnote 31, and this data should not be published on the AER's website.<sup>1</sup>
2. Section 1.2 of the Economic Insights report notes that some DNSP data are based on the their old cost allocation methodologies (**CAMs**). While the report notes this is in line with previous practice and we understand that a single year observation will not materially impact Cobb-Douglas SFA model, we consider data based on the DNSPs' actual (current) CAMs should be used, to more accurately reflect the impact on efficiency frontier and to accurately measure base year opex efficiency.
3. Table 3.2 of the Economic Insight report<sup>2</sup> published alongside the AER's report should be consistent with figure 3.2 of the Economic Insights report and figure 12 of the AER's benchmarking report. It appears there may be labelling issues in table 3.2 of the Economic Insight report.
4. Similarly, table 3.1 in the Economic Insights report should be consistent with figure 3.2 of the Economic Insights report and figure 11 of the AER's benchmarking report.
5. The AER's draft report does not include any information on the operating environment factors (**OEFs**) that are used to normalise the results of

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<sup>1</sup> Letter D17/29505: AER information request – Category Analysis and Economic Benchmarking RINs, 23 May 2017

<sup>2</sup> Economic Insights, Economic Benchmarking Results for the Australian Energy Regulator's 2017 DNSP Benchmarking Report, 6 Sep 2017

econometric cost function approach. As the types of OEFs and the magnitude of their impacts can change for DNSPs over time, it would be informative if AER provided a table showing the OEFs for each DNSP, along with unadjusted and adjusted efficiency scores.

We also recommend that the AER start consulting with stakeholders on the development of an econometric cost function approach for totex benchmarking that could be used to benchmark both opex and capex, with a view to using such an approach to determine expenditure and revenue allowances. The current approach of using benchmarking to only determine opex allowances (and not capex allowances) can create a perverse incentive for DNSPs to capitalise more. Over time, this could result in inefficient increases in regulatory asset bases, leading to higher prices than are necessary for consumers. Furthermore, the use of benchmarking to determine opex only will dilute incentives for DNSPs to pursue real operating efficiency gains that will benefit customers over the long term, and therefore is unlikely to be consistent with the long term interests of consumers.

We recommend AER explore benchmarking at the totex level using a cost function approach separately to this current work on the annual benchmarking report, and also to consider any Rule changes which may be required to enable it to apply totex benchmarking to determine cost and revenue allowances in the future.

Please contact me on (03) 9173 8218 if you would like to discuss this letter further.

Yours sincerely

[signed]

**Sandeep Kumar**  
Manager Regulatory Analysis and Strategy