TasNetworks | Powering a Bright Future

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Sebastian Roberts
General Manager
Network Expenditure
Australian Energy Regulator
GPO Box 520
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Dear Sebastian

RE Submission on the impact of capitalisation on the AER's benchmarking

TasNetworks welcomes the opportunity to make a submission to the Australian Energy Regulator (**AER**) regarding the methods being considered by the AER to reduce the impact that differences in capitalisation practices may be having on the AER's benchmarking of distribution network service provider (**DNSP**) operating expenditure (**opex**). We would also like to acknowledge the considerable effort that has clearly been invested in the consultation paper released by the AER in relation to this issue.

The benchmarking of complex and often diverse electricity network businesses is a difficult exercise, and no benchmarking technique can hope to incorporate every possible factor that might affect a DNSP's opex. When benchmarking metrics are based, by necessity, on a limited range of variables in order to describe attributes that might be considered common to all DNSPs, the results produced by benchmarking models will still be sensitive to the models' specifications and affected by extraneous factors.

For example, while capitalisation practices are not related to the efficiency of opex they can have a material impact on the assessment of a DNSPs' opex efficiency. In this regard, TasNetworks supports the AER's view that capitalisation practices are not presently accounted for in the econometric opex benchmarking models. Removing differences in capitalisation practices as part of the assessment of DNSP's opex efficiency would, therefore, be an important step forward in terms of the precision of the opex models.

TasNetworks has reservations about adjusting the raw efficiency scores calculated by the opex efficiency models using the opex ratios identified in the consultation paper. Opex/total expenditure (totex) ratios are influenced by more factors than just differences in capitalisation polices. Analysis has shown a relationship between DNSPs regulated asset base (RAB) as a proxy for business size and opex/totex, with a smaller RAB associated with a higher ratio. This indicates that the ratio isn't accounting for just differences in capitalisation, rather an element of business size and as such should not be used to adjust efficiency scores.

DNSPs corporate overheads are currently reported through the Regulatory Information Notice process, providing audited data over a large time series. By allocating a fixed proportion of total corporate overheads to opex, the effect of capitalisation policy differences can be removed from the opex benchmarking series, ensuring consistency of benchmarking. Whilst this approach may not account for differences in the allocation/classification of other categories, such as direct costs and network overheads, TasNetworks is of the opinion that it does account for differences in capitalisation practices.

To manage one aspect of the differences in other categories, TasNetworks proposes further investigation into the impacts of opex/capital expenditure (**capex**) trade-offs. One possible solution that could be investigated would be to allow DNSPs to identify material opex/capex trade-offs that should be excluded from the opex benchmarking series. A consideration that would be required is the recognition of both implementation and ongoing costs when assessing the materiality of a proposed exclusion. For example, the use of Software as a Service solutions is envisaged to require a material upfront cost as well as an on-going cost. The decision to take this approach should not be influenced by a fear that the increased opex will result in a reduction of a DNSP's opex efficiency benchmarking outcome.

TasNetworks acknowledges the role that Operating Environment Factors (**OEFs**) play in accounting for the impact of DNSP's different operating environments when comparing opex efficiency. While an OEF could be used to manage differences in capitalisation policies, it is our preference to utilise the alternative approaches. One contributor to this preference is our concern with the setting of OEFs within the regulatory proposal process. TasNetworks' preference would be to disconnect the setting of OEFs from this process and instead incorporate any changes to OEFs into a separate dedicated process. This would allow businesses to enter the regulatory proposal process with a transparent and predictable measure of the efficiency. The proposal to exclude opex/capex trade-off costs could also be incorporated into this dedicated process.

As the consultation paper notes, benchmarking is a complex issue, and we appreciate the AER's commitment to the improvement of its benchmarking program, as well as its willingness to engage with network businesses and other stakeholders as part of its investigation. Once again, thank you for the opportunity to contribute to the AER's benchmarking improvement efforts. If there are any questions on this submission, please contact [redacted] by email: [redacted]

Yours sincerely

[redacted]

Wayne Tucker
General Manager Regulation, Policy and Strategic Asset Management