

17 October 2018

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Dear Evan

Re: Draft AER 2018 Benchmarking Reports

AusNet Services welcomes the opportunity to provide feedback on the AER's draft 2018 Benchmarking Reports prior to their finalisation and publication. AusNet Services has consistently supported the development of a robust benchmarking framework for network businesses in Australia, and will continue to work constructively with the AER towards this end.

This submission comments on both the Distribution and Transmission Benchmarking Reports.

2018 Distribution Benchmarking Report

Between 2016 and 2017, AusNet Services' productivity improved more than any other distribution business in the NEM. This was achieved through substantial opex reductions and was also due to network reliability.

The AER's benchmarking reports are an increasing focus of investors and market analysts in assessing the operational performance of distribution businesses and assessing their market value. With this scrutiny, it is more important than ever that the AER's benchmarking approach is robust, and its consistency, comparability and validity are improving over time. AusNet Services has significant concerns about the draft 2018 benchmarking report, and considers it is a step backwards in terms of its robustness and transparency compared to its predecessors.

The most material of these concerns relate to:

- Inconsistent treatment of corporate overhead opex; and
- Lack of progression in quantifying a vegetation management Operating Environment Factor (OEF), while developing and quantifying far less material OEFs.

The issues are discussed below.

1. *Inconsistent treatment of corporate overhead opex*

Different businesses adopt very different capitalisation approaches to corporate overheads. These accounting decisions are unrelated to the productivity of different networks, but can materially impact the AER's benchmarking results.

Compounding this discrepancy, some businesses' actual capitalisation practices are reflected in the benchmarking results, while others are not. This is not transparently presented in the

benchmarking reports yet is of even larger materiality than the original discrepancy in capitalisation practice.

The issue is not difficult to address or present transparently. For example, the AER already has the data it needs to apply a fixed capitalisation ratio for every network's overheads if it so chose over the entire time series, which would equalise this impact and enable more meaningful conclusions to be drawn about the relative productivity of different networks. In our opinion, this merits being presented to the audience for the report on materiality grounds alone.

We encourage the AER to include this analysis in its final 2018 benchmarking report.

2. Operating Environment Factor Framework

The latest quantified OEF adjustments contained in the SapereMerz report indicate that AusNet Services has the most favourable operating environment in the NEM because it ignores one of the most material OEF in vegetation management. The AER itself acknowledges that AusNet Services' distribution network area faces the highest bushfire risk and most difficult terrain within Australia and, as a consequence, AusNet Services is subject to more stringent vegetation management and asset inspection regulations that very materially increase its opex compared to other distributors. While this is the case for all Victorian networks, there is clearly a disproportionate impact on the rural networks.

However, the AER's benchmarking approach still does not account for this factor as it:

- Includes all vegetation management and inspection-driven opex as an input; and
- Omits any safety-related measures as an output.

The intent of the OEF framework is to account for factors that drive material differences in the productivity of networks, but are not included in any other part of the AER's benchmarking approach. Vegetation management falls squarely into this category.

While the AER recognises that further work is needed and it will consult on the next steps, for the framework to be useful and not further distort the benchmarking results, a robust bushfire mitigation OEF (covering both vegetation management and inspection-related opex) should be developed. Until this is done, the OEF framework should not be given any weight or be said to offer any additional explanatory power to the benchmarking results.

AusNet Services would be pleased to work with the AER in further developing this OEF prior to the 2019 Benchmarking Report.

2018 Transmission Benchmarking Report

We continue to support the current transmission benchmarking model, which was updated last year following an extensive and open consultation process by the AER. We note the significant productivity improvement that has been achieved by the industry between 2016 and 2017, reflecting reliability improvements and should be a welcome result for electricity customers.

Despite the improvements made to the transmission benchmarking model, we remain of the view that it cannot be used deterministically and is most useful for providing insights into trends over time and other high level observations.

Please contact Charlotte Eddy, Manager Economic Regulation on 03 9695 6309 with any questions in relation to this submission.

Sincerely,

A handwritten signature in black ink, appearing to read 'Tom Hallam', written in a cursive style.

Tom Hallam
General Manager Regulation and Network Strategy
AusNet Services