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Claire Preston
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Dear Claire

**Draft 2021 Annual Benchmarking Report for Electricity Distribution**

We appreciate the opportunity to comment on the AER's Draft 2021 Distribution Benchmarking Report.

AusNet has long supported the AER's use of benchmarking to provide insights into the productivity of distribution networks, which are important inputs into its regulatory determination process. However, there has not been a holistic review of the current benchmarking models since they were developed in 2014, and substantive concerns raised repeatedly by AusNet and other networks in recent years about the multilateral total factor productivity (MTFP) and opex and capex multilateral partial factor productivity (OPFP and CPFP) measures in particular have not been adequately addressed. To ensure that stakeholder confidence in the results of these models is maintained, an urgent review is required to investigate the points made in this (and in our previous) submissions.

Stakeholders including the Customer Challenge Panel, other customer advocates and investors place weight in the benchmarking results – specifically the MTFP, OPFP and CPFP charts presented in the report – in reaching conclusions about networks' productivity. While there is material review work outstanding, we consider it important to include some sensitivity analysis in this report. This should include:

- MTFP and OPFP charts showing the results of equalising the capitalisation of overheads across networks; and
- Charts showing the impact of Operating Environment Factors which have been developed and quantified to date.

We appreciate that the AER's regulatory determinations for opex place appropriate weight on the broad range of econometric benchmarking models and partial input metrics, rather than just the OPFP models. However, both the AER and Industry have failed to establish a consistent understanding amongst stakeholders that this is the case. Indeed, in our recent EDPR process, some stakeholders expressed surprise that AusNet was deemed efficient by the AER despite it ranking highly on the broad range of measures because it ranked relative poorly in the OPFP benchmarking (for the reasons explained below). We encourage clearer communication and editorial comment as to the strengths and weaknesses of the various benchmarking techniques developed and how they are applied by the AER.

**Unequal treatment of capitalised overheads is distorting results**

The percentage of overheads networks capitalise reflects different accounting treatments of these costs, rather than genuine differences in productivity. We are glad that the AER will shortly begin to consult on the treatment of capitalisation, and we support the AER developing a uniform approach to capitalisation for benchmarking purposes. This should be administratively simple as the information

required is already collected in the existing RINS. We also understand that normalising capitalisation is a standard feature of many other jurisdictions that utilise benchmarking such as the UK.

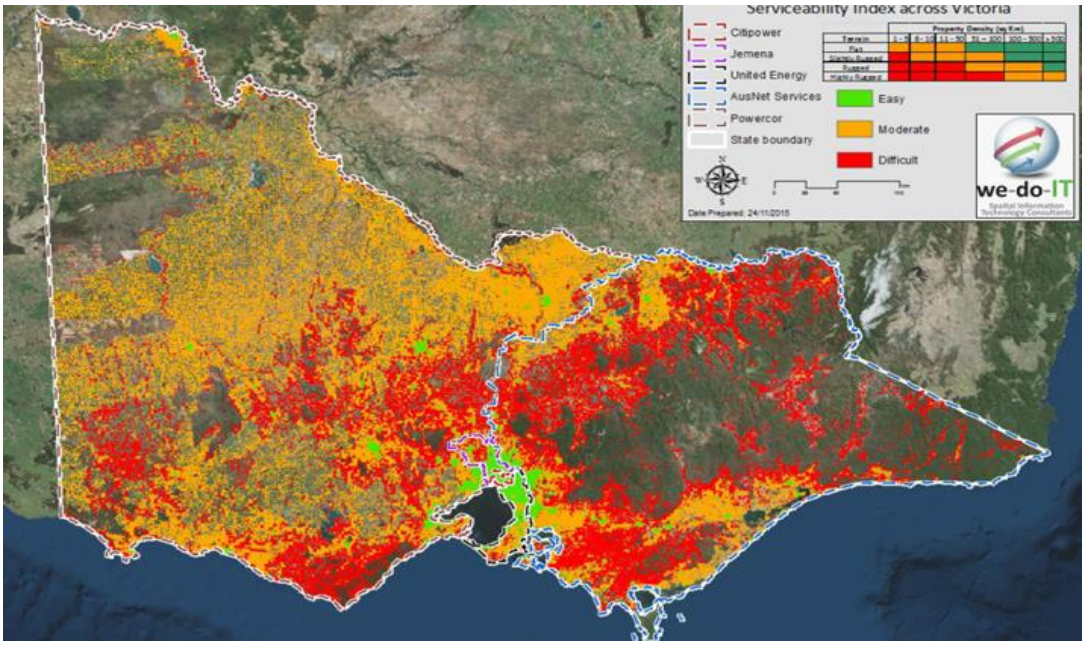
This analysis should correct for the material opex exclusions granted to Citipower and Powercor in the benchmarking to reflect their historic, rather than current, capitalisation policies. In 2020 this resulted in 28% of Powercor's and 18% of Citipower's opex being excluded from the benchmarking analysis, despite being part of their opex cost base and funded by customers on this basis. This treatment has been in place since 2016 and continues to artificially improve their benchmarking positions, by an increasing amount over time. We note that if actual opex were used, the ranking of these networks would fall materiality[1].

**Need to properly account for differences in operating environments**

While we recognise the AER's efforts in developing a suite of Operating Environment Factors, we are concerned that they are not comprehensive and nor are they incorporated in the MTFP and OPFP modelling that stakeholders have most regard to.

AusNet has a high customer density in particularly challenging terrain (for example, throughout the Dandenong and Yarra Ranges), therefore, facing the highest bushfire risk in Australia and some of the poorest inherent reliability. The primary reason for this is the location, topography and vegetation coverage of AusNet's distribution network, which exposes our customers to environmental factors outside of all parties' control.[2] Figure 1 highlights the relative difficulty of servicing AusNet's network (particularly in the eastern half of rural Victoria), compared to the networks of the other Victorian electricity distributors.

***Figure 1: Serviceability index comparing Victorian electricity distributors***




*Source: AusNet Services*

This impacts the benchmarking in numerous ways:

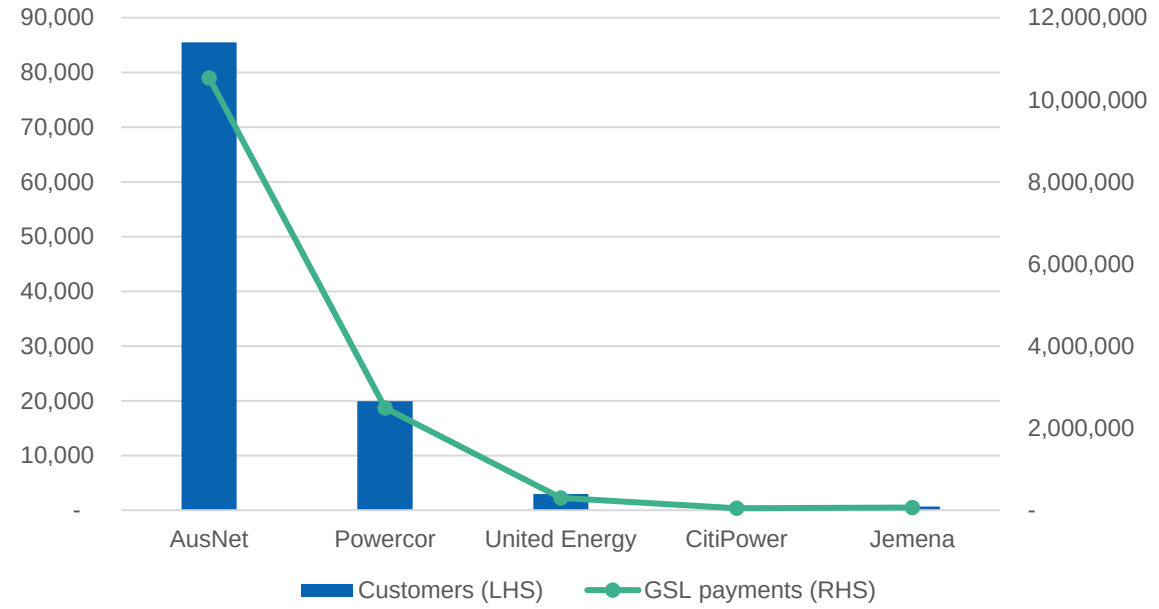
- Vegetation management opex is materially higher than the 'average' networks' due to higher bushfire risk and more stringent vegetation management obligations. The AER has developed an OEF to reflect this;

[1] AusNet, *EDPR Revised Regulatory Proposal*, 3rd December 2021, p. 97 Figure 4.3, available here: https://www.aer.gov.au/system/files/AusNet%20Services%20-%20Revised%20Regulatory%20Proposal%20-%202021-26%20-%20December%202020.pdf

[2] AusNet's distribution network serves the fringe of northern and eastern Greater Melbourne and eastern half of rural Victoria. Approximately 35% of all network feeders have some parts in flood hazardous areas and two-thirds of the distribution network is in areas designated as Bushfire Prone.

- Bushfire liability insurance premiums are materially higher. There is no OEF or adjustment for this.
- Reliability in our network is inherently lower than the 'average' DNSP. Remote, coastal and forested areas often experience more frequent and sustained interruptions due to the environment in those parts of the network and the difficulty in servicing those areas. The network is also poorly supported by the transmission network relative to Powercor's distribution area with just one terminal station supporting the entire Gippsland and Wellington shire regions from the eastern outskirts of Melbourne to the NSW border. This shows up in the benchmarking in a couple of ways:
    - Firstly, reliability is an output. There is no adjustment or OEF for networks with inherently lower reliability due to the environment they operate in.
    - Secondly, Guaranteed Service Level payments are included in opex. As shown in Figure 2, in 2020 AusNet paid over four times the value of GSL payments than Powercor, the closest Victorian DB comparator.

***Figure 1: Actual GSL outcomes (reliability of supply only) in 2020***




*Source: AER, Raw data from annual RIN responses*

We strongly consider GSLs should be removed from opex for benchmarking purposes given:

- This is not a true opex input cost but rather is a mandated transfer between customers. As such it should not be considered in a productivity analysis;
- In setting GSL opex allowances between DNSPs that differ enormously (AusNet's GSL allowance is almost 300x that of CitiPower's), the AER itself implicitly recognises that GSL opex cannot be benchmarked between DNSPs; and
- It is essentially another measure of reliability performance, and therefore double counts reliability in the analysis.

**Inherent differences in outputs impact results**

Our analysis shows that our MTFP and OPFP rankings are supressed due to our relatively low energy per customer and maximum demand per customer (22% and 12% lower compared to Powercor respectively). While we understand that these are reasonable and intuitive network outputs for the purpose of undertaking productivity benchmarking, these factors are also outside of the control of

AusNet and are not material drivers of required opex. These appear to be inherent differences in the way our customers use our network both because of the much higher proportion of residential customers and higher levels of social disadvantage, rather than factors which have any relationship to the efficiency and prudency of our opex. These differences should be explained clearly to stakeholders in benchmarking reports.

The AER's forthcoming review of the impact of Distributed Energy Resources on benchmarking may address the 'double hit' on benchmarking results caused by high solar uptake, being both higher opex (e.g. due to tap changes to manage voltage) and lower energy per customer. Notwithstanding this, we encourage a future model review to explore the impact of inherent differences in outputs on distribution network rankings and whether it is appropriate for the outcomes of the analysis to be heavily impacted by these, and if so, what the results of the analysis convey about a networks' productivity.

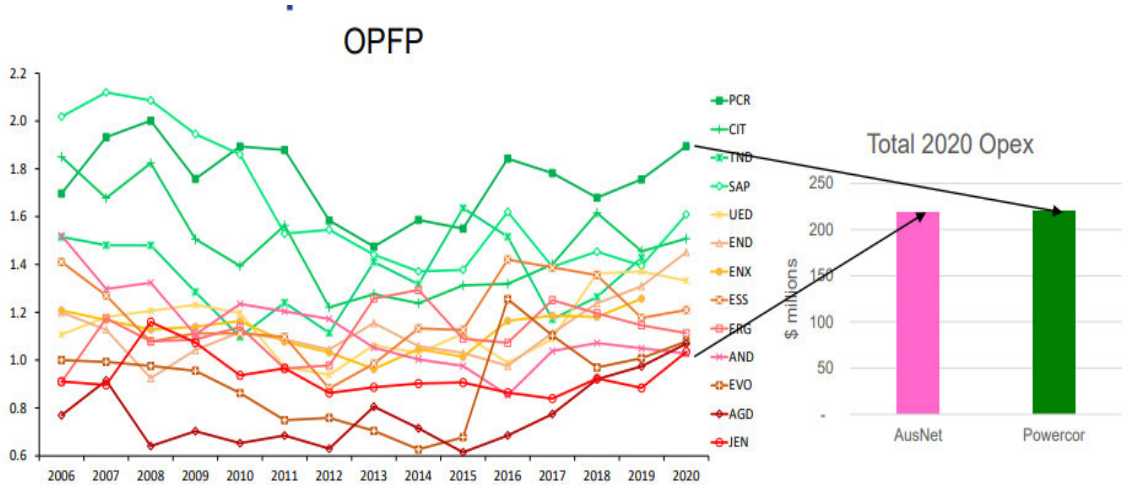
**The plausibility of OPFP results**

The impact of the information outlined above leads to the implausible results outlined below.

***1. Powercor is twice as productive as AusNet in the OPFP analysis despite having the same 2020 opex***

Powercor and AusNet are relatively comparable networks, both being privately owned networks in Victoria which cover rural areas in Victoria with similar customer numbers. However, the 2020 OPFP results ranked Powercor as the most productive network in the NEM, and twice as productive as AusNet, which was ranked least productive in the NEM. Both companies incurred the same amount of raw opex, therefore, it is output measures alone that are driving the result. To a stakeholder, this implies that Powercor is producing double the outputs of AusNet, an outcome that we consider lacks credibility without significant explanation in the benchmarking report.

***Figure 3: AusNet and Powercor OPFP outcomes versus raw opex***



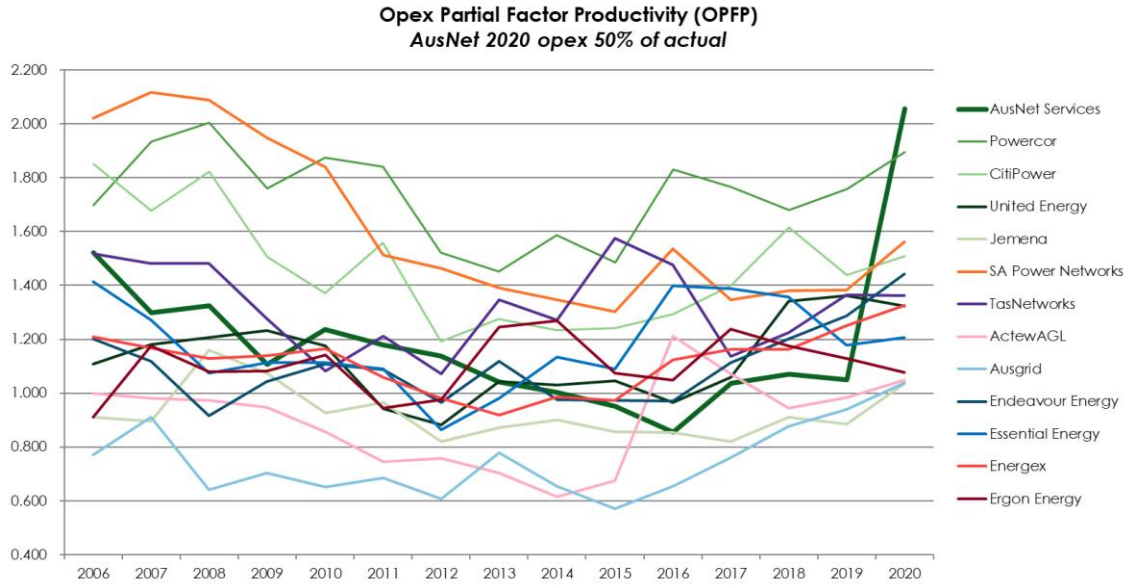

*Source: AER, Raw data from annual RIN responses*

***2. AusNet would need to reduce its opex by 50% to become the most productive network in the NEM***

The chart below shows the 2020 OPFP results if AusNet's 2020 opex had been half of the actual amount. AusNet would have been ranked first in the NEM, narrowly beating Powercor.

AusNet has been operating under strong opex incentive schemes and has materially reduced its opex in the last 5 years. It would be impossible for AusNet to cut its opex by 50% while meeting its compliance obligations and delivering customers their expected level of service.

***Figure 4: Effect of AusNet 50% Opex cut on OPFP performance***




*Source: AER, AusNet analysis*

The fact that opex would need to be halved for AusNet to be ranked first in OPFP demonstrates that other inherent factors in the model (as explained above) are dragging down AusNet's productivity performance.

**Summary and Next Steps**

As explained above, given the outstanding review work that needs to be undertaken, the results of which could materially impact the benchmarking results, we consider the 2021 Benchmarking Report should contain sensitivity analysis in chart form, including equalising capitalisation of overheads across networks, and the impact of applying the current suite of OEFs.

While we note that the report contains commentary about the limitations of the MTFP and the MPFP benchmarking results, this could be strengthened in sections 4.1 and 4.2 to indicate that the issues that have been raised by stakeholders including AusNet have potential to materially change the rankings compared to those presented here. This would also be shown by the sensitivity analysis suggested above.

Finally, we encourage the AER to do a thorough review of the benchmarking model in time for the 2022 Annual Benchmarking Report and look forward to engaging with the AER on this.

Please contact me on [redacted] with any questions about this submission.

Sincerely,

Charlotte Eddy
General Manager Regulatory Strategy and Policy
**AusNet Services**