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Dear Adam

Ausgrid appreciates the opportunity to provide feedback on the Australian Energy Regulator's (AER) draft 2021 Benchmarking Report prior to its finalisation and publication.

We welcome the program of work identified by the AER to improve the benchmarking methodology based on feedback from stakeholders. These suggestions included:

- reviewing the impact of differences in cost allocation and capitalisation approaches;
- an independent review of the non-reliability output weights used in the total factor productivity (TFP) / multilateral total factor productivity (MTFP) benchmarking;
- improving the performance of the opex econometric cost function models and in particular the reliability performance of the Translog (TLG) models;
- reviewing model specifications accounting for distributed energy resources (DER).

As suggested by Ausgrid in its submission to the 2020 benchmarking report, an overall "health check" would also be timely. This health check could cover all the identified areas of development as well as assessing whether the overall methodology remains fit for purpose, given the errors found in 2020. This would also ensure all development areas are considered within the wider benchmarking context, at the same time, and reduce the submission burden on stakeholders.

In the absence of a single review, the timing of the various reviews are of concern to Ausgrid because of the proximity to our regulatory determination cycle. It is not clear whether the outcomes of the reviews will be available to apply to Ausgrid's 2024-29 regulatory determination. We note that the AER took a pragmatic approach in assessing Jemena Electricity Network's (JEN) opex in their recent determination and applied an operating environment factor to account for capitalisation differences. We consider that the AER should adopt a similar approach for the upcoming determinations where it is clear that an issue needs addressing, but the review has not started/completed, for example accounting for DER integration in model specification.

Timing is also critical with respect to the performance of the opex econometric models, in particular the TLG models. The problems encountered with the TLG models mean that results are reported differently for long period (four models, except for CitiPower, JEN and United

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Energy) and short period (two models). Each year, depending on the monotonicity violations, models could be included or excluded for the purpose of determining efficiency for a particular business. This creates significant uncertainty for businesses in the lead up to regulatory determinations where the models are used to test efficiency of revealed base year opex. Ausgrid, along with several other distribution network service providers (DNSPs), are currently preparing for regulatory determinations. We are concerned that there could be different outcomes regarding efficient opex depending on the stability of an econometric model, which has no actual bearing on the efficiency or otherwise of a business in comparison to other businesses.

We note that for JEN, the basis of assessing base year efficient opex changed between draft and final decision. The AER used four econometric models for the long period and three econometric models for the short period in the draft decision, to only having three econometric models for the long period and the two Cobb-Douglas models for the short period in the final decision. This was because of monotonicity violations in the TLG models between the 2019 Benchmarking Report and the 2020 Benchmarking Report. These outcomes make it difficult for DNSPs to plan and engage with customers.

Economic Insights and the AER have explored using a hybrid model by imposing constraints on the TLG model to reduce monotonicity issues. Should this be progressed we would encourage the AER to ensure that thorough testing and peer review of the hybrid model specifications are completed before including this in the benchmarking approach. Consideration of the hybrid or any other model specification could be included within the overall independent 'health check' of the opex benchmarking framework, if it were pursued.

We appreciate the work the AER continues to put into the benchmarking methodologies and encourage the AER to resolve identified issues as soon as possible to provide some level of certainty for the upcoming regulatory determinations.

Regards,

Alex McPherson
Head of Regulation