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By email: expenditure@aer.gov.au.

Dear Chris

Thank you for the opportunity to make a submission on the AER's Draft Expenditure Assessment guidelines.

We acknowledge the considerable amount of effort that the AER has made to develop its approach and specify the data requirements for expenditure assessment.

The AER has specified extensive data to be provided by the NSPs, including back-cast data to 2004. We find it difficult to take a certain position on the value of all these data – much will depend on the use to which it can be put by the AER and others. We have examined the AER's Repex and Augex models and its approach to benchmarking of productivity and operating expenditure.

In each of these areas, the AER has left its precise approach relatively open, with room to move in the application and use of these methodologies. We support this approach. It is sensible to keep options open until the real value of the data is evident. We also fully support the AER's request for back-dated data so that it is able to develop its benchmarks.

We ask the AER to ensure that all benchmark modeling is made available on the AER's website so that this can be replicated and analysed by users and others.

Benchmarking results and information to be shared with consumers

The Draft Guideline says that the AER will share the results of its initial benchmark comparisons with NSPs, before publicly releasing them. We request that the AER also shares this with user representatives, before public release. It is important that users are able to understand how the AER's initial analysis may change as a result of consultation with NSP.

Benchmarking methodology

We support the AER's proposed specification of DNSP and TNSP inputs.

On outputs, we reserve our judgment on the AER's proposed use of "loss of supply events" and "aggregate unplanned outage duration" in the specification of outputs. We support, in principle, the inclusion of quality measures in the benchmarking approach. However, we are concerned, in particular, at the use of the Value of Customer Reliability to value these reliability outputs. There is no certain VCR value, and large changes in VCR, which are quite possible, may undermine the reliability of the benchmarking results.

On the use of system capacity versus actual demand as an output, on page 101 the AER says:

"*Ideally, our preferred model specification would capture required system capacity as an output because this is the level of capacity required by customers to meet their needs*."

We strongly disagree with this. End users do not specify the level of capacity that is required. The EUAA's members seek that NSPs have the least possible capacity to provide reliable supply. There is now significant evidence of excess capacity through-out the NEM's networks following excessive demand forecasts by NSPs, which were accepted by the AER. Failing to account for *actual* demand in the specification of outputs, will mean that inefficient over-spending is not reflected in the benchmark efficiency assessment.

We are also opposed to the use of system capacity on the grounds that it is not objectively measurable, as NSPs have themselves noted.

We support the use of rolling peak demand, say over 3-5 years as the appropriate outputs specification. The approach proposed by Citipower, PowerCor and SA Power Networks to adjust system capacity for *actual* asset utilization also merits investigation.

We note the AER's advisor's concern that the use of actual demand will be volatile. But the use of a rolling average deals with this. The AER has suggested that 14 years of historic data will be needed for a rolling average. This is unnecessary, using a three year rolling average will easily resolve the problem and the AER's back-casting to 2004 will provide such historic demand data.

For these reasons we suggest that the primary model specification should use rolling average actual demand as an output. The AER's measure of system capacity should then be used in sensitivity analysis.

This is a significant concern to our members. The AER's benchmarking assessment is likely to lack credibility with the EUAA and its members if, by using system capacity rather than actual demand as the output, it calculates NSPs to be efficient in spite of the evidence of significant amounts of excess, stranded capacity.

On the use of regression approaches to determine weighting factors for outputs, we broadly support the AER's proposals in this.

Step and trend approach in opex determinations

We reserve our judgment on the AER's approach to setting opex allowances. While we broadly support the methodology, we are concerned that the use of constant productivity change estimates over the regulatory period can mean that energy users will be deprived of step change reductions in opex that should occur for those NSPs whose efficiency is substantially below the efficiency frontier. We appreciate that the AER is also considering step change adjustments in "base" opex, but seek more clarification on how this would work in practice.

A long road remains to be traversed to implement these guidelines. We look forward to engagement in this.

Yours sincerely

Phil Barresi
Chief Executive Officer