18 October 2018

Evan Lutton
Assistant Director, Networks
Australian Energy Regulator
Level 17, 2 Lonsdale Street
Melbourne, Vic 3000

Dear Mr Lutton,

RE: AER Draft 2018 Economic Benchmarking Report for DNSPs

Endeavour Energy appreciates the opportunity to provide a response to the AER's Draft 2018 Annual Benchmarking Report (ABR or draft report). The draft report was circulated on 27 October and also included the final report from Sapere Merz on the post-modelling adjustments for material Operating Environment Factors (OEFs) associated with the econometric models.

Draft 2018 Benchmarking Report

The ABR is the primary tool used by the AER, stakeholders and DNSPs to assess the relative efficiency of DNSPs. As such, we (and most likely other DNSPs) use the results and rankings as a management tool to monitor performance and drive efficiency improvements. We have engaged with our staff, community and customers through benchmarking and have committed to improving our performance over the coming years.

As noted in the draft report, we have incurred significant short term costs over the last few years reducing our labour costs. Our 2016-17 performance demonstrated that we are beginning to see the benefits of our efficiency program with a 6% improvement in our MTFP score, the third largest improvement in the NEM. For the 2017-18 year we committed to achieving the AER's efficient opex allowance from the 2014-19 determination and using this as the base year for forecasting our 2019-24 opex requirements.

Given the MTFP model is a key input into long-term business planning decisions we consider it is critical that there remains simplicity, consistency and transparency over time. We are therefore concerned by the re-weighting of the MTFP model output specifications. Specifically, the reduction in weighting of customer numbers and associated increase to ratcheted maximum demand and circuit line length. Economic Insights notes an expanded dataset enabled the change and that the impacts are small[1]:

> *The expanded database allows the models to attribute infrastructure–related costs more directly. Using the updated weights does not make a large change to the productivity levels results although the rural DNSPs do somewhat better under the updated weights and some urban DNSPs do slightly less well.*

Whilst the re-weighting is characterised as immaterial in the draft report we consider its impacts to be material. On average, the re-weighting had a larger impact on the DNSPs performance than their actual performance over the following 12 month period. This was particularly driven by what we consider to be substantive step changes in the scores of rural DNSPs as evident in the table below.

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[1] Economic Insights, *Economic Benchmarking Results for the Australian Energy Regulator's 2018 DNSP Annual Benchmarking Report*, 10 August 2018, p. 2

Table 1 – MTFP Results 2016-17 compared to 2015-16

DNSP	Change to 2016 MTFP score from specification change	Change in MTFP score from 2016 to 2017
AusNet Services	-0.66%	11.78%
Ausgrid	-1.40%	3.98%
CitiPower	-2.94%	2.53%
Endeavour Energy	1.69%	5.78%
Energex	0.15%	0.89%
Ergon Energy	14.92%	6.76%
Essential Energy	10.03%	-3.48%
Evoenergy	-0.60%	-4.45%
Jemena	-5.48%	-0.66%
Powercor	4.22%	2.29%
SAPN	6.41%	-7.18%
TasNetworks	4.73%	-8.47%
United Energy	-5.17%	3.89%
Average	**1.99%**	**1.05%**

We accept that as additional data becomes available the AER will be able to refine existing techniques and introduce additional models. We recognise that it is important that businesses are heading towards a realistic and desirable endpoint. Organisational change is a long-term exercise, which needs to be supported by clear and static targets (i.e. the 'goalposts'). Our concern with the 2018 draft report is whether the trade-off between accuracy and usefulness/consistency has been properly considered. A pattern of frequent and material changes to the model will undermine stakeholder confidence and the credibility of the benchmark.

Economic Insights conducted a comprehensive review[2] in determining the appropriate output measures and weightings. In doing so they concluded that customer numbers were the most significant and costly output measure[3]. We raised our concerns with the weightings during the consultation process and the AER considered it had selected the best specification[4].

We have accepted the outcome of this process and sought to improve our performance against the measures as set. Whilst the specification change improved our 2016 MTFP score our ranking retrospectively changed from 8th to 9th due to the improvements made by rural DNSPs.

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[2] Economic Insights, *Economic Benchmarking of Electricity Network Service Providers Report prepared for Australian Energy Regulator*, 25 June 2013

[3] Economic Insights, *Memorandum, DNSP MTFP Result*, Date: 2 July 2014

[4] AER, *Electricity distribution network service providers – Annual benchmarking report*, November 2014, p 28.

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Our preference would be to maintain the previous weightings. A key purpose for the publication of benchmarking data is transparently measuring performance and encouraging DNSPs to respond accordingly. Amending how measures are calculated can inhibit a DNSPs ability to establish long term plans and organisational commitment to respond and improve. We therefore favour stability over precision in best incentivising DNSPs to respond continuously and positively to the ABR.

If the AER and/or Economic Insights consider a change is necessary we consider a more fulsome consultation process is required. We would like to better understand the rationale for changing the output specification, how this improves the accuracy of the model and whether this improvement is worth making the revision to the model (at the expense of consistency). The time currently provided to review the draft report is more suited to error checking.

We recommend that the current consultation process for the annual benchmarking report is confined to data checks and that only immaterial revisions are made to the model. Any material changes to the model should be made on a less frequent basis (e.g. every 3-5 years) and subject to a more extensive consultation process. We consider the impacts of this re-weighting would constitute a material change based on the outcomes outlined above.

Operating Environment Factors

The draft report includes a section on the impact of differences in operating environments. We welcome this inclusion as it is important to note the differences outside of a DNSPs control that may help stakeholders better understand a DNSPs relative efficiency. The section focusses on the final report from Sapere-Merz which quantifies a number of OEFs.

The AER notes that they will consult further on these OEFs as part of refining the assessment and quantification of these factors. We support this approach as there are a number of issues that will need to be addressed following the Sapere-Merz report. Our concerns mainly arise from the significant change in the OEFs between the draft and final report (e.g. from 8.78% to 3.36% for Endeavour Energy).

If applied in their current form these OEFs, when applied to the outcomes of the AER's preferred econometric model, significantly shift the efficient opex targets of all DNSPs. As discussed earlier, material and sudden changes in critical benchmarking tools can undermine stakeholder confidence. We have made significant improvements in achieving the AER's previous efficient opex target by 2017-18. Any changes to target opex should be well considered and incremental in nature so that they incentivise continual improvement from DNSPs rather than one-off step changes in allowances.

The change between the draft and final report was primarily driven by moving from a capacity based to a transformer count based measure of sub-transmission asset volumes with a threshold capacity of 15 MVA. We have concerns with this change as we do not consider 15 MVA transformers to be analogous from an operating cost perspective to managing 120 MVA transformers operating at 132 kV that would be the responsibility of TNSPs outside of NSW and QLD.

We also consider the change is inconsistent with the data provided in the Benchmarking RIN (table 3.5.2 and the associated definitions) and subsequently the capacity based input measures used in the MTFP, MPFP and econometric models.

In addition to this, there are several other issues which are acknowledged to be open to further consultation that we have an interest in:

- Taxes and levies – Sapere-Merz emphasis the indicative nature of the current estimates as they are based on an initial and incomplete dataset and therefore require further review.

- Topography and terrain differences – Sapere-Merz identifies this as an area for further investigation.

- Vegetation management – this is a material cost for many DNSPs as evidenced by the Sapere-Merz analysis. While insufficient data is currently available we consider it is likely to be a material OEF given the jurisdictional differences in obligations and responsibilities for vegetation management.

Overall we are supportive of the serious and detailed assessment of OEFs made by the AER in improving the robustness of the ABR and we look forward to contributing in further discussions on this matter.

Other matters

In reviewing the draft report and accompanying data we have found one minor error. In 'DNSP consolidated benchmarking data – September 2018.xlsx' worksheet 'Opex Price Index' cells L34 to Y34 there is a formula error in the opex price index:

- Current Formula: *2016/17 Price Index (cell T34) = SUM(Dec-15 Index, Mar-16 Index, Jun-16 Index, Sep-16 Index)/4*

- Suggested Formula: *2016/17 Price Index (cell T34) = SUM(Sep-16 Index, Dec-16 Index, Mar-17 Index, Jun-17 Index)/4*

If you have any queries or wish to discuss this matter further please contact me on (02) 9853 4386 or via email at jon.hocking@endeavourenergy.com.au.

Yours sincerely,

Andrew Schille
General Manager Regulation & Corporate Affairs
Endeavour Energy