20 September 2013

Chris Pattas
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Australian Energy Regulator
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Dear Mr Pattas,

Draft Expenditure Forecast Assessment Guideline for Electricity Distribution

CitiPower, Jemena Electricity Networks, Powercor Australia, SP AusNet and United Energy Distribution (**the Victorian Distributors**) welcome the opportunity to respond to the Australian Energy Regulator's (**AER**) Draft Expenditure Forecast Assessment Guideline for Electricity Distribution (**Draft Guideline**) and the associated Explanatory Statement, which were released on 9 August 2013.

In the time available, it has not been possible to conduct a complete review of all the material contained in the Explanatory Statement. This submission therefore focuses primarily on the content of the Draft Guideline. Silence on some of the positions the AER has taken in the Explanatory Statement should not therefore be construed as an endorsement of these positions.

Key messages

The Victorian Distributors appreciate the effort the AER has put into addressing many of the issues raised in the original submissions and the level of consultation it has engaged in to date. While there are still a number of significant issues that the Victorian Distributors believe need to be carefully considered before the Guideline is finalised, it would be positive if the AER continues to engage with stakeholders in the constructive manner it has to date.

The issues that the Victorian Distributors consider the AER should focus on when finalising the Guideline are set out below:

- The objective of the Guideline should be to provide DNSPs with greater guidance on how the AER will assess their expenditure proposal, rather than to prescribe the basis on which they should prepare their forecasts.
- The scope of the Guideline should be refined, so that it provides greater clarity on the approach and techniques the AER intends to apply in the next round of distribution determinations, as opposed to those that *may* be applied at some point in the future.

- The Guideline should be able to operate on a stand-alone basis *vis-à-vis* the Explanatory Statement and incorporate any principles or criteria the AER intends to apply when assessing expenditure forecasts.
- The operating expenditure (**opex**) chapter of the Guideline, should be revised to address the following matters:
  - It should be made clear that DNSPs can choose what forecasting technique to use and that the AER's task is to assess whether the proposal is consistent with the opex criteria set out in clause 6.5.6(c) of the National Electricity Rules (**NER**).
  - A new section should be introduced, which recognises the potential for techniques other than the base-step-trend approach to be employed and sets out how the AER would assess such proposals.
  - The restrictive definition of step changes contemplated in section 5.3 should be removed, because it is contrary to the opex criteria, the revenue and pricing principles and the National Electricity Objective (**NEO**).
  - The proposal to only allow 'exceptional' regulatory obligation step changes should be removed, because no analysis has been undertaken to test the validity of this proposal, or to assess whether it satisfies the opex criteria or revenue and pricing principles.
  - The productivity growth factor should be removed from the rate of change parameter, because it is inconsistent with a number of Efficiency Benefit Sharing Scheme (**EBSS**) provisions in clause 6.5.8 of the NER and revenue and pricing principles.
- The principles to be used by the AER when determining what assessment techniques to employ should be based on those proposed by the Energy Networks Association (**ENA**).
- Further consideration should be given to the information the AER requires to assess opex and capital expenditure (**capex**) forecasts, because it is not clear that all of the proposed information is: necessary; proportionate to the underlying issue the AER is trying to address; and expected to yield a net economic benefit.
- The AER should carefully consider the significant costs that will be incurred in collecting the range and volume of 'back cast' data it has proposed, and also consider if this is justified by the expected benefit. Further, the quality of back cast data and its inherent limited usefulness should be recognised and factored into how the AER uses it in decision making.

Each of these issues is discussed in detail below.

1. Objective, scope and content of the Guideline

Two key concerns the Victorian Distributors have with the Draft Guideline are the lack of clarity that has been provided about:

- the objective of the Guideline, which should be to set out how the AER will assess NSPs expenditure proposals, rather than to prescribe the basis on which NSPs should prepare their forecasts; and
- the assessment techniques the AER will apply in the forthcoming distribution determinations, as opposed to those it *may* apply at some point in the future.

The latter issue was raised in a number of the submissions made to the original issues paper.[1] These submissions noted that if the AER focused on developing assessment techniques that have limited scope for application today, it would not fulfil its obligations under clause 6.4.5 of the NER. It was also noted that the resultant Guideline would be inconsistent with the intent of the Australian Energy Market Commission (**AEMC**) and the AER's stated intention of providing regulatory certainty.

Notwithstanding the significance of this issue, the Draft Guideline still refers to a number of techniques that are incapable of being used at this time. The economic benchmarking techniques identified in chapter 3 of the Draft Guideline are a case in point. That is, while the AER has acknowledged in the Explanatory Statement that it is unlikely to be able to rely on these techniques in the 'short term',[2] the discussion in various sections of the Draft Guideline[3] suggest that these techniques are capable of being employed now, and that DNSPs should prepare their regulatory proposals accordingly. The Draft Guideline in its current form is therefore quite misleading and has the potential to create a significant degree of regulatory uncertainty and additional work for DNSPs, as they prepare for their impending reviews.

The significance of this issue cannot be understated. The Victorian DNSPs would therefore urge the AER to provide DNSPs with greater guidance on how it intends to assess their expenditure forecasts in the next round of determinations, by doing one of the following:

- limit the scope of the current Guideline to those techniques that are *capable* of being employed in the upcoming round of determinations. If, at the end of this round of determinations (i.e. mid-2018), it has been established that the economic benchmarking techniques satisfy the principles set out in section 3 below, the AER could consider amending or replacing the Guideline, in accordance with clause 6.2.8(e) of the NER;
- adopt a five year term for the new Guideline and limit the scope of the guideline to those techniques that are *capable* of being employed over this five year period; or

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1 See for example, CitiPower, Powercor Australia and SA Power Networks, Joint Response to AER Issues Paper Expenditure Forecast Assessment Guidelines for Electricity Distribution and Transmission, 15 March 2013, p4.

2 See for example the following extract taken from the Explanatory Statement:

> 'Transitional issues will arise as we develop assessment techniques. These issues include those associated with data requirements (section 6.3.2), but also the effectiveness of the techniques…
>
> …
>
> With these issues in mind, we may not rely on some techniques proposed in the Guidelines in the short term, or we may place less weight on these techniques.'

AER, Draft Expenditure Forecast Assessment Guideline – Explanatory Statement, August 2013, p76.

3 See for example, sections 3.3.1, 5.1, 5.2 of the Draft Guideline.

- create a separate section in the Guideline, which clearly distinguishes between those techniques that are *capable* of being applied in the upcoming round of determinations and those that *may* be used in subsequent rounds (i.e. post mid-2018), if it is established they satisfy the principles in section 3.

In determining whether a technique is 'capable' of being applied, the AER should have regard to:

- the time it is likely to take to collect and validate any data, develop the underlying models, test the validity of the models and demonstrate the models satisfy the principles set out in section 3; and
- whether all of the work set out in the preceding bullet point is likely to be completed before DNSPs are required to notify the AER of their expenditure forecast methodologies.

In terms of the content of the Guideline, many of the principles and criteria identified in the Explanatory Statement as being relevant to the AER's assessment are not reflected in the Draft Guideline. Given the Guideline is the only document that has status under chapter 6 of the NER, it should be able to operate on a stand-alone basis. Accordingly, any principles or criteria the AER intends to employ when assessing expenditure forecasts should be included in the Guideline.

The Victorian Distributors would also suggest the content of the Guideline be refined to clarify that:

- the NER have primacy in any assessment of a DNSP's expenditure proposal;
- the starting point for any assessment of expenditure will be the DNSP's proposal; and
- the AER's role is to assess a DNSP's expenditure proposal and not to prescribe the use of a particular forecasting technique.

2. Assessment of opex forecasts

Chapter 5 of the Draft Guideline and section 4.2 of the Explanatory Statement set out the AER's proposed approach to assessing a DNSP's opex forecasts. In both of these documents, the AER has made it clear that its preference is to use the base-step-trend forecasting technique, although it has acknowledged there may be circumstances where it is appropriate to use other techniques. Chapter 5 of the Draft Guideline also prescribes how the base-step-trend approach is to be applied, i.e:

- Base year expenditure is to be determined as follows:[4]
  - if the AER finds the DNSP's revealed costs reasonably reflects the opex criteria, it will allow the revealed costs to be used; or

[4] AER, Draft Expenditure Forecast Assessment Guideline for Distribution, August 2013, p15 and AER, Draft Expenditure Forecast Assessment Guidelines – Explanatory Statement, August 2013, p35.

- if the AER finds the DNSP is 'materially inefficient compared to its peers' and its revealed costs are inconsistent with the opex criteria, it will either require the use of a different base year, or adjust the base opex so it 'reasonably reflects the opex criteria'.

- Step changes will only be allowed for changes in expenditure arising as a result of non-discretionary changes in inputs, efficient capex/opex trade-offs and changed regulatory obligations.[5] In relation to this latter category, the AER has noted its starting position is that only 'exceptional' regulatory obligation events are likely to require compensation.[6]
- The rate of change (trend) parameter is to incorporate an output growth, real price growth and productivity growth factor.[7]

A number of concerns arise from the AER's proposed approach, including:

- the presumption that the AER can prescribe what opex forecasting technique DNSPs use, which is contrary to the propose-respond model, the AEMC's intention and a number of provisions in chapter 6 of the NER, including clauses 6.4.5(a) and S6.1.2(6);
- the limited consideration that has been given to DNSPs using forecast techniques, other than the base-step-trend approach;
- the definition of base year opex in the AER's proposed base-step-trend formula, which incorrectly refers to final year opex being used and also creates some confusion with the inclusion of the 'efficiency adjustment' term;
- the restriction the AER has tried to impose on the type of step changes it will allow, which constitutes a significant departure from its current approach and is contrary to the opex criteria and revenue and pricing principles;
- the proposal to only allow 'exceptional' regulatory obligation related step changes, because no analysis has been carried out by the AER to test the validity of this starting point, or to assess whether it satisfies the opex criteria and revenue and pricing principles; and
- the provision made for productivity in the rate of change parameter, because it contravenes a number of important EBSS provisions and revenue and pricing principles.

These concerns are discussed in further detail below.

2.1 Role of the AER in assessing opex forecasts

In a number of instances throughout chapter 5 of the Draft Guideline, the language used by the AER implies that:

- the AER has the power to mandate the use of a particular opex forecasting technique; and
- the AER, rather than the DNSP, is responsible for developing opex forecasts.

Some examples of this can be seen in the extracts below:[8]

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5 AER, Draft Expenditure Forecast Assessment Guideline for Distribution, August 2013, pp. 16-17.

6 AER, Draft Expenditure Forecast Assessment Guideline – Explanatory Statement, August 2013, pp. 32-33.

7 AER, Draft Expenditure Forecast Assessment Guideline for Distribution, August 2013, p16.

'**We prefer a 'base-step-trend' approach to forecasting** most opex categories. However, when appropriate, **we may forecast** some opex categories using other forecasting techniques, such as an efficient benchmark amount.

Using the base-step-trend forecasting approach, **we will determine** forecast opex in year t as:…' [emphasis added]

'We will forecast opex for the forecast regulatory control period by applying an annual rate of change for each year of the forecast regulatory control period. **We will determine** the annual rate of change for year *t* as…' [emphasis added]

The characterisation of the AER's role in each of these extracts is clearly at odds with:

- the propose-respond model underpinning chapter 6 of the NER;
- the objective of the Guideline, which as defined in clause 6.4.5 of the NER is to set out the approach the AER proposes to use to *assess* a DNSP's forecasts;
- clause S6.1.2(6) of the NER, because directors of a DNSP will not certify that the assumptions underpinning the opex forecast are reasonable if the forecast is derived on a different basis to what the DNSP actually uses; and
- the AEMC's expectation of how the AER should assess expenditure proposals, as reflected in the following extract:[9]

  'The NSP's proposal is necessarily the starting point for the AER to determine a capital expenditure or operating expenditure allowance, as the NSP has the most experience in how its network should be run. Under the NER the AER is not "at large" in being able to reject the NSP's proposal and replace it with its own since it must accept a reasonable proposal.'

If the extracts above were the only examples of this issue, the Victorian Distributors would suggest some revisions to these sections of the Draft Guideline. The problem is though that the entire chapter is predicated on the assumption that the AER can dictate what forecasting technique is to be used and how it should be applied. The whole of chapter 5 therefore needs to be revised, to bring it into line with the requirements of clause 6.4.5 of the NER, and to make it clear that:

- DNSPs can choose what forecasting technique to use when developing their proposed opex forecasts; and
- the AER's task is to assess whether a DNSP's proposal is consistent with the opex criteria and *not* to prescribe the use of a particular technique, or to develop its own forecasts, unless it determines the DNSP's proposal does not satisfy the opex criteria.

As a guide, the Victorian Distributors would suggest the AER model the revised chapter 5 on chapter 4 of the Draft Guideline, or on sections B.6.1, B.7.1 and B.8.1 of the Explanatory Statement, because they are more in keeping with what is contemplated by clause 6.4.5 of the NER.

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8 ibid, pp. 15-16.

9 AEMC, Rule Determination – National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2012, November 2012, pvii.

2.2 Recognition of other forecasting techniques

In the introduction to chapter 5 of the Draft Guideline, the AER has acknowledged there may be instances where it is inappropriate to use the base-step-trend forecasting technique. However, the remainder of the chapter presumes that all opex will be forecast using the base-step-trend approach. No guidance has therefore been provided on how the AER would assess opex forecasts derived using an alternative approach.

In the Victorian Distributors' view this is a real gap in the Draft Guideline, particularly given the potential for some forms of opex not to follow the base-step-trend path (e.g. non-recurrent expenditure, self-insurance, debt raising costs and opex that increases at a faster or slower rate than the rate of change parameter). To address this gap, the Victorian Distributors would suggest a new section be introduced into chapter 5, which:

- recognises the potential for other forecasting techniques to be used by a DNSP; and
- sets out the matters the AER would consider when assessing such forecasts.

2.3 Definition of base year opex in base-step-trend formula

The formula the AER proposes to employ when the base-step trend forecasting approach is used is reproduced below:

Base year opex

$$Opex_t = \prod_{i=1}^{t}(1 + rate\ of\ change_i) \times (deemed\ final\ year\ opex - efficiency\ adjustment) \pm step\ changes_t$$

The concerns the Victorian Distributors have with the base year opex component of this formula are two-fold:

- First, the formula refers to actual opex in the *final* year of the preceding regulatory control period ('deemed final year opex') being used, even though:
  - base year opex is usually set equal to actual opex in the penultimate year; and
  - the AER has indicated it may utilise another base year if the revealed costs are found to be inconsistent with the opex criteria.

  To overcome this definitional issue, the Victorian Distributors would suggest the term 'deemed final year opex' be replaced with the term 'base year opex'.
- Second, it is unclear from the description in the Draft Guideline whether the 'efficiency adjustment' will be applied in all circumstances, or only in those cases where a DNSP's revealed costs are found to be inconsistent with the opex criteria. Given the AER's intention appears to be that such adjustments will only be made in the latter of these cases, the Victorian Distributors would suggest that either:
  - the definition of the term 'efficiency adjustment' be amended, so that it is clear it will only be applied if a DNSP's revealed costs are found to be inconsistent with the opex criteria; or

- the term 'efficiency adjustment' be removed from the formula and the definition of the term 'base year opex' set out the alternative ways in which it may be measured, which will differ depending on whether or not the revealed costs are found to reasonably reflect the opex criteria.

While on the topic of 'efficiency adjustments', the Victorian Distributors are of the view that if a DNSP is subject to the EBSS, its base year opex should *not* be subject to such an adjustment. This is because the EBSS should, by design, encourage the DNSP to seek out efficiencies during the regulatory period and reveal their efficient costs. Imposing an additional efficiency adjustment in this case would result in:

- the base year opex being set at a lower level than the efficient cost the operator incurs in providing the service (contrary to s. 7A(2) of the NEL); and
- the incentives provided by the EBSS being undermined (contrary to s. 7A(3) of the NEL), because the sharing ratio would be diluted and efficiency gains/losses would no longer be fairly shared between the DNSP and customers[10] (contrary to cl. 6.5.8(a) of the NER).

2.4 Restriction on types of step changes

In section 4.2.3 of the Explanatory Statement,[11] the AER has stated that step changes will be added 'where they are necessary to produce a forecast that is consistent with the opex criteria'. Elaborating further on what it considers would constitute a step change, the AER has stated the following in section 5.3 of the Draft Guideline:[12]

> 'Step changes must be made only for changes in outputs not captured by the output growth variable. Step changes should only include the forecast costs of non-discretionary changes in inputs, other than capex/opex trade-offs. The drivers for the step change should be external to the control of the DNSP.
>
> If it is efficient to substitute capex with opex, a step change may be included for these costs (capex/opex trade-offs). Step changes should not double count the cost of increased regulatory burden over time, which forecast productivity growth may already account for.'

The use of the terms 'non-discretionary' and 'external to the control of the DNSP' in this extract imply that the AER will no longer recognise the validity of step changes arising from the following sources, even if they are 'necessary to produce a forecast that is consistent with the opex criteria':

- changes in the DNSP's operating environment;[13]

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[10] The EBSS would no longer provide for a fair sharing because the DNSP would only be rewarded if they achieved efficiency gains in the next regulatory period in excess of the assumed 'efficiency adjustment'. The DNSP would therefore capture less than 30% of efficiency gains and bear more than 30% of efficiency losses.

[11] AER, Draft Expenditure Forecast Assessment Guideline Explanatory Statement, August 2013, p37. Elsewhere in the Draft Guideline and Explanatory Statement, the AER has characterised step changes as follows:

> '…the addition of step changes accounts for any other efficient costs not captured in base opex.' (Draft Guideline, p15).
>
> 'Any other costs that would meet the opex criteria but are not compensated for in the rate of change can be added as a step change' (Explanatory Statement, p34).

[12] AER, Draft Expenditure Forecast Assessment Guideline, August 2013, pp. 16-17.

[13] These changes could include exogenous changes in the volume or scale of activities undertaken by a DNSP.

- changes in expenditure arising from changed practices and policies; [14]
- changes in opex arising as a result of new capex projects; and
- discretionary projects that are required to achieve the opex objectives set out in clauses 6.5.6(a)(1), (3)-(4) of the NER, or are otherwise in the long term interests of consumers as prescribed in the NEO.

The AER's proposal to restrict step changes in this manner, contravenes the opex criteria in clause 6.5.6(c) of the NER, the NEO and section 7A(2) of the NEL. It is also contrary to the following position taken by the AER in the 2011-15 Victorian Electricity Distribution Price Review (EDPR) final decision, which at the time was described as being consistent with clauses 6.5.6(a), (c)(1) and (2) of the NER:[15]

> 'Step changes primarily provide an allowance for incremental costs arising from regulatory obligations, changes in the operating environment or where the base year opex allowance would not be sufficient for the DNSP to meet or manage the expected demand for standard control services, maintain the quality, reliability and security of supply, or maintain the reliability, safety and security of the distribution system.'

In the Victorian Distributors' view, the definition of step changes adopted in the Guideline should reflect the current understanding of step changes and be modelled on the approach taken by the AER in the 2011-15 EDPR final decision (see extract above), subject to the following refinements:

1. The definition should explicitly refer to the proposed step change being consistent with the opex criteria.
2. Step changes should be allowed where the expenditure is required to enable the DNSP to act in accordance with 'good electricity industry practice', as required by various provisions in the NER and other instruments.
3. Step changes should be allowed where the expenditure is required to address the concerns of electricity consumers, as contemplated by clause 6.5.6(e)(5A) of the NER.
4. When considering whether step changes proposed under clauses 6.5.6(a)(3) and (4) of the NER are likely to be required, the AER should be able to have regard to the DNSP's network performance indicators (e.g. capacity, risk or network 'health' indicators).
5. The definition should recognise, as the AER did in its recent Victorian Gas Access Arrangement Review,[16] that step changes may be required to ensure discretionary projects

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[14] These changes could include changes in external obligations (e.g. changes in the nature and level of consumer engagement that DNSPs are expected to undertake) and/or changes in the interpretation of these obligations (e.g. changes in the way Energy Safe Victoria applies existing safety management obligations).

[15] AER, Final Decision – Victorian electricity distribution network service providers –2011-2015, October 2011, p317.

[16] In this decision, the AER noted the following:

> 'In some limited circumstances the benefits of a discretionary project may not be productivity gains, but the project is expected to lead to lower prices to customers. If there are few benefits to the gas service provider, the benefits of undertaking the project to the gas service provider may not outweigh the cost of the project. Therefore it may not undertake the project without an increase in opex. A step change in opex may be necessary so that customers benefit in the long term.'

See AER, Access arrangement final decision – Envestra Ltd 2013-17, March 2013, Part 2, p 171

that are in the long term interests of users (e.g. they deliver lower prices or other benefits to customers), but are of limited benefit to the DNSP, are undertaken. In deciding whether or not to approve this type of step change, the AER could consider whether the proposed project is:

- in the long term interests of consumers, as prescribed by the NEO;
- expected to yield a positive net economic benefit over the life of the project;[17] and
- consistent with the opex criteria.[18]

The Victorian Distributors would therefore suggest that the existing material in section 5.3 of the Draft Guideline be replaced with the following definition of step changes:

> 'Step changes provide an allowance for incremental costs arising from regulatory obligations, changes in the DNSP's operating environment, or where the base year opex allowance would not otherwise be sufficient for the DNSP to:
>
> i. achieve the opex objectives set out in clause 6.5.6(a) of the NER;
> ii. behave in accordance with 'good electricity industry practice', as defined in chapter 10 of the NER;
> iii. address the concerns of electricity consumers, as identified in the course of the DNSP's engagement with consumers; and/or
> iv. implement projects that would be in the long term interests of consumers (as set out in the NEO) and are expected to yield a positive net economic benefit.
>
> Step changes will be allowed where it can be demonstrated that the proposed expenditure reasonably reflects the opex criteria in clause 6.5.6(c) of the NER and the base year opex allowance would not be sufficient for the DNSP to satisfy paragraphs i-iv.
>
> When considering whether to allow step change related to clause 6.5.6(a)(3) or (4) of the NER, the AER may have regard to the DNSP's network performance indicators.'

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[17] The net economic benefit should be calculated having regard to:

- the present value of any benefits (excluding the effect of any wealth transfers) accruing to consumers and the DNSP and any other potential beneficiaries of the proposed project (e.g. generators); and
- the present value of the proposed expenditure.

[18] In relation to this proposed refinement, the Victorian DNSPs understand that the AER has sought to dismiss dynamic efficiency related step changes in the Explanatory Statement, on the grounds that DNSPs would be rewarded for any productivity improvements through incentive mechanisms and should therefore fund such expenditure. The Victorian Distributors disagree with the position the AER has taken on this issue and note that this line of logic is unlikely to hold for projects that are designed to improve dynamic efficiency over the longer run given:

(a) the length of time it can take to realise the benefit of such improvements, which when coupled with the fact that a DNSP is only entitled to retain 30% of any productive efficiencies, may mean a DNSP has no incentive to fund the project, even though it may be consistent with the NEO and opex criteria; and

(b) that dynamic efficiency improvements (which can take a variety of forms including productive efficiency, improvements in product/service quality and/or the development of new products/services) may give rise to significant benefits for consumers but little benefit for the DNSP. In a similar manner to (a), a DNSP in this situation may have no incentive to fund the project, even though it is consistent with the NEO and opex criteria.

Projects of this nature are therefore, as the AER recognised in the recent Victorian GAAR, only likely to be undertaken by a DNSP if they are funded through an explicit step change.

2.5 Regulatory obligation related step changes

In the Explanatory Statement, the AER has stated it will consider what constitutes a regulatory obligation step change at each review. However, its starting position is that only 'exceptional' events are likely to require compensation, because the productivity factor in the rate of change will already reflect the 'historic average' effect of changes in regulatory obligations.[19]

The principal concern the Victorian Distributors have with this proposal, is that AER has not undertaken any quantitative analysis to test the validity of its proposed starting point or to determine whether it is consistent with the opex criteria and section 7A(2) of the NEL. Nor has the AER sought to demonstrate why the proposed starting point is the logical extension of the more general hypothesis that the productivity factor already captures the 'historic average' effect of regulatory changes. In the Victorian Distributors' view, all that follows from this hypothesis is that DNSPs should be compensated for changes in expenditure on regulatory obligations in excess of the 'historic average', which is a much lower threshold than the AER's proposed starting position.

Setting this aside, even if the AER was to alter its starting position and allow step changes in excess of the 'historic average', the Victorian Distributors query whether it will be possible to develop a robust estimate of the effect of changes in regulatory obligations on the productivity factor. The Victorian Distributors would therefore suggest that before requiring DNSPs to account for any 'historic average' effect captured in the productivity factor, the AER should satisfy itself that:

- it is possible to quantify the effect of changes in regulatory obligations embodied in the productivity factor in an accurate, reliable, robust and transparent manner and in a way that will ensure the opex criteria and section 7A(2) of the NEL are satisfied; and
- the effect of changes in regulatory obligations embodied in the productivity factor is material enough to warrant the significant costs that are likely to be involved in trying to estimate its value.

Finally, it is worth noting that if the productivity growth factor is removed from the rate of change, as the Victorian Distributors believe it should be (see section 2.6), then there would be no need to deal with any of the problems set out above.

[19] AER, Draft Expenditure Forecast Assessment Guideline - Explanatory Statement, August 2013, pp. 32-33.

2.6 Rate of change

In section 5.2.1 of the Draft Guideline, the AER has stated that the rate of change parameter used in the base-step-trend forecasting technique is to be calculated as follows:

$$\text{Rate of change}_t = \text{output growth}_t + \text{real price growth}_t - \text{productivity growth}_t$$

The provision made for productivity in the rate of change constitutes a significant departure from the position the AER has previously taken on this issue,[20] and is of particular concern because it is contrary to a number of EBSS provisions and revenue and pricing principles.

Put simply, if a productivity factor is included in the rate of change then it will mean that:

- contrary to clause 6.5.8(c)(3) of the NER, DNSPs achieving an efficiency gain less than the productivity factor would be penalised, notwithstanding the fact there has been an efficiency gain;
- contrary to clause 6.5.8(a) of the NER, the EBSS would no longer provide for a fair sharing of gains and losses, because DNSPs would only be rewarded if they achieved efficiency gains in excess of the productivity factor. DNSPs would therefore capture less than 30% of efficiency gains and bear more than 30% of efficiency losses;
- contrary to section 7A(2) of the NEL, DNSPs may not have the opportunity to recover at least the efficient costs; and
- contrary to section 7A(3) of the NEL, the effectiveness of the incentives accorded to DNSPs would be diminished, because:
  - the EBSS would no longer provide for the fair sharing or symmetric treatment of efficiency gains/losses; and
  - the incentives provided by the EBSS *vis-à-vis* the Capital Expenditure Sharing Scheme (CESS) would be unbalanced.

The Victorian Distributors are therefore of the view that no provision should be made for an assumed productivity improvement in the rate of change parameter.

In relation to the real price growth factor, the Victorian Distributors understand the AER has expressed a preference to use the Australian Bureau of Statistics' wage price index (WPI) for the labour cost component. Although it is useful to know what the AER's preference is, the Victorian Distributors are of the view that a decision on what real price escalator to use should be left to the regulatory determination stage and assessed by the AER at this time having regard to the opex criteria.

The other observation the Victorian Distributors would make about the real price growth factor, is that to ensure some degree of consistency between the economic benchmarking and opex forecasts, the same real price escalators should be used across the two.

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[20] AER, Final Decision – Electricity distribution network service providers - Efficiency benefit sharing scheme, June 2008, p13.

Finally, the Victorian Distributors consider that it is appropriate to maintain the output growth factor in the rate of change parameter. As the AER itself recognises, operating expenditure increases due to factors such a customer numbers, line length and energy demand.

3. Proposed assessment principles

Section 4.5.1 of the Explanatory Statement sets out a number of principles the AER has stated it *may* apply when determining what assessment techniques will be used. Consistent with the ENA's submission, the Victorian Distributors believe that a number of the proposed principles are:

- unnecessary because they are addressed in other principles (e.g. the validity principle);
- inconsistent with the opex criteria, the NEO and the revenue and pricing principles (e.g. the parsimony principle); or
- require further clarification (e.g. the transparency, robust, fit for purpose and accuracy and reliability principles).

The Victorian Distributors would therefore recommend the AER adopt the following principles developed by the ENA and the definitions it has proposed for each of these principles:

- Accuracy and reliability;
- Robustness;
- Transparency;
- Fitness for purpose; and
- Consistency and predictability.

Consistent with the ENA's recommendations, these principles should be applied to both the assessment techniques and the associated data requirements.

If the application of these principles results in the identification of numerous techniques that could be used for a particular expenditure category, then the relative weighting to be assigned to each technique should be determined having regard to the following matters identified by the ENA:

- Acceptance of the technique – techniques that have broader demonstrated regulatory acceptance and proven effectiveness should be weighted more heavily;
- Technique limitations – techniques that have few limitations in terms of accuracy, reliability and robustness should be weighted more heavily;
- Data limitations – techniques that use data with few limitations in terms of accuracy, reliability and robustness should be weighted more heavily;
- Corroboration – techniques whose results can be corroborated with the results of other techniques should be weighted more heavily;

- Accommodation of differences in NSP's circumstances – techniques that can accommodate differences in circumstances should be weighted more heavily; and
- Accommodation of exogenous events – techniques that can accommodate the effect of matters outside an NSP's control should be weighted more heavily.

4. Information provision and sign-off requirements

Chapter 6 of the Draft Guideline sets out at a 'high level', the information the AER is likely to require when carrying out its assessment of a DNSP's expenditure forecasts, while the Explanatory Statement provides further detail on the information and sign-off requirements.

The key concerns the Victorian Distributors have with this aspect of the AER's proposal are that:

- inadequate consideration has been given to whether the proposed information requirements are necessary, proportionate to the underlying issue the AER is trying to address and expected to yield a net economic benefit;
- limited consideration appears to have been given to:
  - the significant costs that DNSPs will incur in collecting the range and volume of back cast data proposed by the AER and whether these costs are justified by the expected benefit; and
  - how the AER will account for the inherent limitations with back cast data in its decision making process.
- the requirement to provide 10 years of independently audited back cast financial and non-financial data, in such a short period of time is unreasonable and it is unclear whether an auditor would be willing to provide the requisite sign-off for all of the information.

These concerns are outlined in further detail below.

4.1 Assessment of the proposed information requirements

The AER's proposed information requirements require the provision of more detailed, disaggregated and standardised information on their proposed expenditure forecasts than has been provided to date. While the AER has recognised that there will be additional costs associated with providing this information, it has stated that it expects the 'benefits from collecting the proposed data will outweigh the expected collection costs'.[21]

The Victorian Distributors understand the AER's desire to have access to more information when assessing expenditure forecasts. However, the provision of such information is not without cost. Before imposing any additional reporting requirements on DNSPs, the AER must therefore satisfy itself that the provision of information, at the level of detail and

[21] AER, Draft Expenditure Forecast Assessment Guideline - Explanatory Statement, August 2013, p46.

disaggregation envisaged in chapter 6 of the Draft Guideline and Appendix B of the Explanatory Statement, is:

- actually required, given both the manner in which the AER intends to assess forecast expenditure and the operation of incentive schemes;
- proportionate to the issue it is intended to address. The following extract, taken from COAG's guidance on best practice regulation, is instructive in this regard:[22]

  > "Proportionality involves ensuring that government action does not 'overreach', or extend beyond addressing a specific problem or achieving the identified objective. The scope or nature of government action should be commensurate with the magnitude of a problem, its impacts, or the level of risk without action. **The principle of proportionality applies equally to the implementation of regulation, including the development of frameworks for ensuring compliance."** [emphasis added]

- expected to yield a net economic benefit (i.e. it is consistent with the NEO), having regard to both:
  - the benefit of having access to the detailed and disaggregated information; and
  - the costs that will be incurred by both the DNSP in providing this level of detailed and disaggregated information (which will ultimately be borne by consumers) and the AER in processing and assessing all of this material.

The Explanatory Statement suggests that the AER has already considered the latter of these issues and, in doing so, 'carefully considered likely reporting costs'.[23] However, no estimates of reporting costs, or analysis of the benefits of the proposed informational requirements, have been provided in the Explanatory Statement. Nor is there any indication that the AER has considered whether the information requirements for each expenditure category are proportionate, or necessary given the manner in which it intends to assess these forecasts.

A good example of the latter of these points can be found in the AER's proposed information requirements for vegetation management. In this case the AER has made it clear that it intends to continue assessing this expenditure category on an *aggregated* basis under the base-step-trend approach and to rely on revealed costs if base year opex is found to reasonably reflect the opex criteria.[24] It is still proposing, however, to collect a significant amount of detailed and disaggregated data from all DNSPs on matters such as:[25]

- tree growth rates by zone and factors affecting those growth rates (e.g. tree types, historic rainfall, sun exposure, temperature and correlation of changes in historic expenditure to a rainfall, temperature or sunshine index);
- tree cutting cycles by zone;

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22 COAG, Best Practice Regulation: A Guide for Ministerial Councils and National Standard Setting Bodies, October 2007, p6.

23 AER, Draft Expenditure Forecast Assessment Guideline - Explanatory Statement, August 2013, p46.

24 ibid, p192.

25 ibid pp. 186-194.

- tree trimming expenditure by zone (e.g. the number of trees trimmed, ground clearance cost per km and cost per tree cut);
- easement clearance expenditure per km by zone;
- audit and inspection costs per km by zone;
- access track clearance expenditure per km by zone;
- travel costs including time spent travelling and living away from home costs;
- regulatory/legislative requirements; and
- fire starts due to vegetation contact and unplanned sustained outages and faults due to vegetation contact.

It is difficult in this case to see how the AER has formed the view that the provision of such an inordinate amount of granular information is:

- necessary, given the AER intends to continue to rely on aggregated data and that the EBSS should provide a DNSP with a strong incentive to seek out efficiencies in this area;
- proportionate, particularly if it has been established that the DNSP's base year opex reasonably reflect the opex criteria and it is responding to the EBSS; and
- expected to yield a net economic benefit given that:
  - the costs associated with recording and providing this level of information will be significant; and
  - the benefits of obtaining this information will be negligible because the AER intends to continue to rely on aggregated data.

This is just one example, but in the Victorian Distributors' view it clearly demonstrates that insufficient consideration has been given by the AER to whether the information requirements set out in Appendix B of the Explanatory Statement and chapter 6 of the Draft Guideline are:

- actually required;
- proportionate; and
- expected to yield a net economic benefit.

Given that consumers will ultimately pay for the provision of this information, the Victorian Distributors strongly encourage the AER to go back and conduct a rigorous and transparent review of its proposed information requirements having regard to the three matters set out above. To provide stakeholders with the confidence that there is genuine value in collecting this level of information, the results of this assessment should be made public.

As part of this review, the AER should also consider whether there would be any value in requiring less information from DNSPs whose base year opex is found to reasonably reflect the opex criteria *vis-à-vis* those DNSPs whose opex requires closer review. This would

ensure that customers only pay for the provision of information that is required to make efficient decisions under the NER.

4.2 Provision of 'back cast' data

Another key element of the AER's proposed reporting and sign-off requirements, is the requirement for DNSPs to provide 10 years of independently audited back cast financial and non-financial data by February 2014.

The Victorian Distributors understand that the provision of this information is intended to enable the AER to implement economic benchmarking techniques earlier than was originally envisaged by the AEMC in the *Review into the use of total factor productivity for the determination of prices and revenues*.[26] That is, rather than collecting standardised data on a forward looking basis and implementing the techniques when a sufficiently long time series of data has been collected, the AER is trying to circumvent the informational gap by requiring NSPs to provide historical data.

While there is no doubt the AER's proposed approach will enable economic benchmarking to be used more rapidly, it is important to recognise that back cast data is not a good substitute for collecting data in the manner envisaged by the AEMC, because:

- NSPs may not have access to the all of the historic data required (e.g. because there has been a change in ownership, the NSP is adhering to the Australian Tax Office's seven year tax records rule, the NSP's systems were not set up to record that data, or there was an outsourcing arrangement in place and the NSP does not have the requisite records); or
- NSPs may not have previously recorded data in a standardised manner over time, or relative to other NSPs.

A back cast data set is therefore likely to have some significant informational gaps and be of a substantially poorer quality than data collected in the manner envisaged by the AEMC. The AER's proposal to allow NSPs to come up with their own assumptions to resolve any data limitations, while pragmatic, could further diminish the integrity of the back cast data set.

In the Victorian Distributors' view, these data limitations are significant and must be carefully considered by the AER and factored into how it uses such data in its decision making process. It would be a problem if the AER proceeded with the collection of this information, without some pragmatism around the quality of the back cast data, the results provided by it, and how these results will be used.

In addition to acknowledging the limitations of back cast data, the AER should also recognise that:

- DNSPs will incur significant costs in collecting the range and volume of back cast data proposed by the AER; and

[26] AEMC, Final Report: Review into the use of total factor productivity for the determination of prices and revenues, 30 June 2011.

- the net benefit of collecting back cast data is likely to be much *lower* than it would be for data collected in a standardised prospective manner, because:
  - the cost of collecting and estimating the back cast data will be far higher than the cost of collecting standardised data from this point forward; and
  - the quality of the back cast data will be much lower and subject to greater measurement error than the quality of data collected in a standardised manner from this point forward.

For the reasons set out above, the Victorian Distributors are of the view that if the AER decides to proceed with the collection of back cast data, the following should occur:

- The AER should limit the burden and costs the data collection process imposes on NSPs, by only requiring the provision of data it knows will be required to populate the preferred model specifications, or to test the sensitivity of the data/model specifications.
- NSPs should be required to use their best endeavours to provide the information and should *not* be required to provide information they don't have access to, or information that is unreliable, or potentially misleading.
- The AER should assess whether the data satisfies the principles set out in section 3 above and commit to not relying on information that is unreliable or misleading.
- The AER must recognise the inherent limitations of the data and the effect this may have on the quality of the results, when applying any benchmarking techniques. If the AER is to try and use the benchmarking in a deterministic manner (e.g. when calculating the productivity factor to be used in the rate of change), it must also consider whether the application is consistent with the expenditure criteria, the revenue and pricing principles and the NEO.

Further thought should also be given by the AER to its proposed:

- timing for the provision of back cast data for economic benchmarking and category analysis; and
- the sign-off requirements for this data.

The Victorian Distributors' views on these two issues are set out below.

4.2.1 Timing of provision of back cast information

RIN for economic benchmarking

The Victorian Distributors' understand the AER is currently proposing that back cast data for economic benchmarking be provided within three months of the final economic benchmarking RIN being issued, i.e. in February 2014. This provides insufficient time to collate the data and for the data to then be reviewed by an auditor given the existence of the following constraints:[27]

[27] AER, Draft Expenditure Forecast Assessment Guideline – Explanatory Statement, August 2013, p74.

- The AER's expectation that NSPs provide 'high quality and reliable' data.
- Some of the data the AER is seeking has not been recorded in the manner required by the AER. It will therefore take NSPs time to determine what assumptions should be made to comply with the data requirements and to document those assumptions.
- The AER's requirement that NSPs obtain auditor sign-off, means that the data and the assumptions made by NSPs needs to be of a standard that an auditor would be prepared to provide the requisite sign-off.

The latter of these constraints is particularly problematic. The Victorian Distributors would therefore suggest that the AER do one of the following:

- if the sign-off requirements are to be maintained, the AER should, at a minimum, allow NSPs an additional three months to provide the economic benchmarking back cast data (i.e. data provided in May 2014);[28] or
- if the February 2014 deadline is to be maintained, the AER should give further consideration to the sign-off requirements attached to this data provision.

RIN for category analysis

In relation to the category analysis (back cast) RIN, the Victorian Distributors understand that the AER intends to publish the final RIN in February 2014 and that NSPs will have three months to provide the back cast data, i.e. in May 2014.

The information the AER proposes to collect through this RIN is extensive and in the Victorian Distributors' view it will be extremely challenging to collate all of this data within the three month period to the standard expected by the AER, even if the sign-off requirements were relaxed. The Victorian Distributors would therefore suggest the AER do one of the following:

- if a decision is made to collect all of the proposed data, the AER should allow NSPs an additional three months to provide this information (i.e. data provided in August 2014); or
- if the deadline of May 2014 is to be maintained, the AER should refine the list of data it requires so that NSPs are able to comply with the deadline.

If the latter of these options is selected, the data request could be restricted to the information that is necessary to enable the AER to produce the first annual benchmarking report and to assess the NSW/ACT DNSPs' expenditure proposals. To the extent there are additional categories of data that would be useful to have, but are not critical for either of these purposes, this data could be collected over a longer period of time.

[28] The Victorian Distributors understand that the AER has tried to head off such a request by stating that it would expect NSPs to be making the 'necessary preparations to provide information' given the consultation that has been carried out to date. However, as the AER has itself acknowledged in the Explanatory Statement, there have been some significant changes in the specification of the preferred model, and associated inputs, outputs and environmental variables throughout this process. It is unreasonable therefore for the AER to expect NSPs to have started to collect this type of information.

4.2.2 Sign-off requirements for back cast data

The AER is currently proposing that all back cast data be independently audited and that reasonable assurance on financial and non-financial data be provided, in accordance with ASA 800 and ASAE 3000, respectively.

While the Victorian Distributors agree that any data used in benchmarking must be of a high standard, the reality is that there are likely to be some significant limitations with the historical data, both in terms of availability and the quality of the data. It may also be necessary for some material assumptions to be made when estimating the value of certain categories of data, because the data doesn't exist in the form required by the AER.

Given the nature of this task, it may be quite difficult to find an auditor that is willing to provide the level of assurance sought by the AER, particularly in relation to non-financial data. The Victorian Distributors would therefore suggest the AER consider allowing an independent engineering consultant to sign-off on a NSP's non-financial data and limit the auditor sign-off requirement to financial data.

In the Victorian Distributors' view, this type of sign-off would not diminish the standard of assurance provided to the AER. To the contrary, it is likely to be of greater value than auditor sign-off, because engineering consultants are more familiar with the data and nature of the business. They are therefore more likely to test the assumptions and identify any issues or errors more rapidly than an auditor.

4.2.3 Other general benchmarking issues

While on the topic of benchmarking, the Victorian Distributors would like to reiterate a point that was made in a number of submissions to the AER's original issues paper, but has not been addressed by the AER. That is, if a NSP provides the AER with confidential information, then the AER should *not* use this information in any benchmarking that is applied to other NSPs, unless the other NSPs are provided access to the confidential information, by way of a confidentiality undertaking or some other measure.

In relation to the proposed release of benchmark models, the Victorian Distributors understand the AER is proposing to release the models prior to the publication of its annual benchmarking report. While the Victorian Distributors' welcome this proposal and believe it will be an important step in the development process, they are concerned that there will be very little time to test the models before the AER is due to publish the first annual benchmark report. They would therefore suggest that all data and models be published as soon as possible to ensure that there is an effective consultation process prior to the first report being published. Going forward, the AER should also commit to making the models and data available during each determination process and annual benchmarking review, so that stakeholders can understand how the analysis has been undertaken.

4.3 Other miscellaneous issues

Some other miscellaneous issues that have been identified with the AER's proposed reporting requirements are set out below:

- The categories the AER proposes to use when assessing capex forecasts differ from those used in both the PTRM and roll forward model. To ensure there is some degree of consistency in reporting across each of these elements, the Victorian Distributors would suggest the AER revise the PTRM and roll forward model to bring them into line with the new capex reporting requirements.
- The introduction to chapter 6 of the Draft Guideline currently refers to the AER requiring forecast information on an ongoing basis.[29] The use of the term 'on an ongoing basis', suggests that DNSPs will be required to provide forecasts more frequently than the NER actually requires and the AER intends. This term should therefore be replaced with the phrase *'as part of a DNSP's regulatory proposal'*.
- In the course of reviewing chapter 6 of the Draft Guideline, the Victorian Distributors have identified a number of issues with the drafting of various information provisions in chapter 6 of the Draft Guideline. These issues are set out in the table below along with some suggested revisions.

Table 1: Suggested revisions to Chapter 6 of the Draft Guideline

Provision in Draft Guideline	Issue	Suggested Revision
Items (3)(b) and (7) on pages 18-19	These provisions are duplicated.	Item (7) should be removed.
Items (6) and (8) on pages 18-19		Item (6) should be removed.
Item (3) on page 18	This provision refers to opex rather than capex.	Replace the term 'operating and maintenance expenditure' with 'capital expenditure'.
Items (2)(b) and (2)(c) on page 20	It is unclear how much historical information the AER expects to be provided.	The AER should clarify what is meant by the term 'historical information' (e.g. current regulatory control period or further back).
Item (2)(d) on pages 22 Item (2)(d) on page 23 Item (2)(c) on page 24	These provisions should apply to both legal and regulatory obligations, given the potential for changes in maintenance costs, vegetation management and overheads to come from both of these sources.	Include the term 'regulatory' in these provisions.
Back cast dataset provisions on pages 21 and 24	Apart from being duplicated in sections 6.1 and 6.2, it is not clear these provisions should be included in the Guideline, given the data will be provided on a one-off basis.	Remove these provisions from the Guideline.

5. Summary

Attachment A contains a summary of the more significant issues the Victorian Distributors have identified with the Draft Guideline and their recommendations on how each issue should be addressed.

[29] AER, Draft Expenditure Forecast Assessment Guideline for Electricity Distribution, August 2013, p18.

6. Closing remarks

The Victorian Distributors look forward to continuing to be involved in the development of the Guideline and would be happy to meet with the AER if it would like to discuss any of the matters outlined in this submission further. If you would like to arrange such a meeting, or would otherwise like to discuss any of the issues set out above, please contact Renate Tirpcou on (03) 9683 4082 or rtirpcou@powercor.com.au.

Finally, it is worth noting that the Victorian Distributors have contributed to the development of the ENA's response to the Draft Guideline. A number of the Victorian Distributors have also prepared their own submissions on issues that are of particular interest to their business. This submission should therefore be read alongside these submissions.

Yours sincerely,

Manager of Regulatory Projects
CitiPower Pty and Powercor Australia Ltd
On behalf of the five Victorian Distributors

Attachment A: Summary of issues and recommendations

Topic		Issue	Recommendation
Scope and content of the Guideline		The Draft Guideline provides little guidance on the techniques the AER expects to employ in the next round of determinations.	The Guideline should focus on the approach and techniques the AER knows it will be in a position to employ in the upcoming round of determinations.
		Many of the principles and criteria set out in the Explanatory Statement are not reflected in the Draft Guideline.	The Guideline should be capable of operating on a stand-alone basis and include all of the principles and criteria the AER intends to employ. The Guideline should also make it clear that: ▪ the NER have primacy in any assessment of a DNSP's expenditure proposal; ▪ the starting point for any assessment of expenditure will be the DNSP's proposal; and ▪ the AER's role is to assess a DNSP's expenditure proposal and not to prescribe the use of a particular forecasting technique.
Assessment of opex forecasts (chapter 5 of the Draft Guideline)	Role to be played by the AER	The way in which the AER has characterised its role in chapter 5 of the Draft Guideline is contrary to the propose-respond model, clauses 6.4.5 and S6.1.2(6) of the NER and the AEMC's expectation of how the AER should assess expenditure proposals.	The whole of chapter 5 should be revised to bring it into line with the requirements of clause 6.4.5 of the NER and to make it clear that: ▪ DNSPs can choose what forecasting technique to use when developing their proposed opex forecasts; and ▪ the AER's task is to assess whether a DNSP's proposal is consistent with the opex criteria.
	Other techniques	Limited consideration has been given to the potential for techniques other than the base-step-trend approach being employed	A new section should be included in chapter 5 of the Guideline, which recognises the potential for other forecasting techniques to be used and sets out how the AER would assess such proposals.
	Base year opex	The base year opex component of the AER's proposed formula incorrectly refers to using the final year opex and also creates some confusion with the inclusion of the term 'efficiency adjustment'.	The term 'deemed final year opex' should be replaced with 'base year opex'. The term 'efficiency adjustment' should be removed and the definition of the term 'base year opex' should describe the alternative ways in which this will be measured, depending on whether revealed costs are reasonably consistent with the opex criteria.
	Step changes	The AER's proposal to restrict step changes to non-discretionary changes in inputs, efficient capex/opex trade-offs and changes in regulatory obligations, is contrary to the opex criteria, the NEO and section 7A(2) of the NEL. It also represents a significant departure from the position the AER has taken to date.	The existing material in section 5.3 of the Draft Guideline should be replaced by the following definition and assessment framework: Step changes provide an allowance for incremental costs arising from regulatory obligations, changes in the DNSP's operating environment, or where the base year opex allowance would not be sufficient for the DNSP to: i. achieve the opex objectives set out in clause 6.5.6(a) of the NER; ii. behave in accordance with 'good electricity industry practice', as defined in chapter 10 of the NER; iii. address the concerns of electricity consumers, as identified in the course of the DNSP's engagement with consumers; and/or iv. implement projects that would be in the long term interests of consumers (as set out in the NEO) and are expected to yield a positive net economic benefit. Step changes will be allowed where it can be demonstrated that the proposed expenditure reasonably reflects the opex criteria in clause 6.5.6(c) of the NER and the base year opex allowance would not be sufficient for the DNSP to satisfy paragraphs i-iv. When considering whether to allow step change related to clause 6.5.6(a)(3) or (4) of the NER, the AER may have regard to the DNSP's network performance indicators.
	Regulatory obligation step changes	The validity of the AER's proposed starting point for allowing regulatory obligation step changes (i.e. 'exceptional' events are only likely to require explicit compensation) has not been tested and could contravene section the opex criteria and 7A(2) of the NEL.	Before imposing a requirement on DNSPs to exclude the effect of any double counting between the productivity factor and proposed step change, the AER should satisfy itself that: ▪ it is possible to quantify the effect of regulatory changes embodied in the productivity measure in an accurate, reliable, robust and transparent manner and in way that will ensure the opex criteria and section 7A(2) of the NEL are satisfied; and ▪ the effect of changes in regulatory obligations embodied in the productivity factor is material enough to warrant the costs that will be involved in estimating its value.
	Rate of change	The AER's proposal to include a productivity factor in the rate of change violates a number of important EBSS provisions (cl. 6.5.8(a) and (c)(3)) and revenue and pricing principles (ss. 7A(2)-(3)).	The productivity factor should be removed from the rate of change parameter.
Proposed assessment principles		A number of the principles the AER proposes to apply when determining what assessment techniques it will use are unnecessary, inconsistent with the opex criteria and/or require further clarification.	The AER should adopt the principles proposed by the ENA.

Topic			Issue	Recommendation
Information provision and sign-off requirements	Assessment of proposed information requirements		The AER appears to have given limited consideration to whether the information requirements proposed in chapter 6 of the Draft Guideline and Appendix B of the Explanatory Statement are necessary, proportionate to the underlying issue it is trying to address and expected to yield a net economic benefit.	The AER should conduct a rigorous, thorough and transparent review of whether all the information contemplated in chapter 6 of the Draft Guideline and Appendix B of the Explanatory Statement (by expenditure category) is: ▪ actually required, given the manner in which the AER intends to assess forecast expenditure and the extent to which it can rely on the operation of incentive schemes; ▪ proportionate to the issue it is intended to address; and ▪ expected to yield a net economic benefit from consumers' perspective, having regard to both: – the benefit of having access to the detailed and disaggregated information; and – the costs that will be incurred by both the DNSP in providing this level of detailed and disaggregated information and the AER in processing and assessing all of this material. To provide stakeholders with the confidence that there is genuine value in collecting this level of information, the AER should make the results of its assessment public. The AER should also consider whether there would be any value in requiring different levels of information from those DNSPs' whose base year opex is found to be reasonably reflect the opex criteria vs those that don't. This would ensure that customers only pay for the provision of information that is required to make efficient decisions under the NER.
	Provision of back cast information		Limited consideration has been given by the AER to: ▪ the significant costs that DNSPs will incur in collecting the range and volume of back cast data proposed by the AER and whether these costs are justified by the expected benefit; and ▪ how the AER will account for the inherent limitations with back cast data in its decision making process.	If a decision is made to proceed with the collection of back cast data, the following should occur: ▪ The AER should limit the burden and costs the data collection process imposes on NSPs, by only requiring the provision of data it knows will be required to populate the preferred model specifications, or to test the sensitivity of the data/model specifications. ▪ NSPs should be required to use their best endeavours to provide the information and should *not* be required to provide information they don't have access to, or information that is unreliable, or potentially misleading. ▪ The AER should assess whether the data satisfies the principles set out in section 3 above and commit to not relying on information that is unreliable or misleading. ▪ The AER must recognise the inherent limitations of the data and the effect this may have on the quality of the results, when applying any benchmarking techniques. If the AER is to try and use the benchmarking in a deterministic manner, it must also consider whether the application is consistent with the expenditure criteria, the revenue and pricing principles and the NEO.
	Timing of provision of back cast data	Economic benchmarking	The AER has underestimated how long it will take to provide the back cast information, given the existence of the following constraints: the AER's expectation that NSPs provide 'high quality and reliable data'; some of the data the AER is seeking is not recorded in the manner required by the AER; and the AER's requirement that NSPs obtain auditor sign-off. The latter of these constraints is particularly problematic.	The AER should do one of the following: ▪ if the sign-off requirements are to be maintained the AER should, at a minimum, allow NSPs an additional three months to provide the data (i.e. data provided in May 2014); or ▪ if a decision is made to proceed with collecting this data with a deadline of February 2014, the AER should give further consideration to the sign-off requirements attached to this data provision.
		Category analysis	Even if the sign-off requirements were relaxed, it will be extremely challenging for NSPs to collate all of the back cast data the AER proposes to collect through the category analysis (back cast) RIN.	The AER should do one of the following: ▪ if the deadline of May 2014 is to be maintained, the AER should refine the list of data it requires, so that NSPs are able to comply with the deadline; or ▪ if a decision is made to collect all of the proposed data, the AER should allow NSPs an additional three months to provide this information (i.e. data provided in August 2014).
	Sign-off requirements		Auditors may be reluctant to sign-off on data that needs to be manipulated to get it into the form required by the AER.	The AER should consider allowing independent engineering consultants to sign-off on non-financial data. This type of sign-off would not diminish the standard of assurance and may be of greater value than auditor sign-off, because independent engineering consultants are familiar with the data and nature of the business.
	Use of data		No reliance should be placed on a NSP's confidential information if the benchmarking is to be extended to other NSPs.	If a NSP provides the AER with confidential information, the AER should *not* use this information in any benchmarking that is applied to other NSPs, unless the other NSPs are provided access to the confidential information, by way of a confidentiality undertaking or some other measure.