

19 December 2018



Sebastian Roberts
General Manager, Network Opex and Reset Coordination Branch
Australian Energy Regulator

By email: AERInquiry@ aer.gov.au

Dear Mr Roberts,

Submission to Forecasting productivity growth for electricity distributors draft decision

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in New South Wales. Established in 1982, PIAC tackles systemic issues that have a significant impact upon people who are marginalised and facing disadvantage. We ensure basic rights are enjoyed across the community through litigation, public policy development, communication and training. The Energy + Water Consumers' Advocacy Program represents the interests of low-income and other residential consumers, developing policy and advocating in energy and water markets.

PIAC welcomes the opportunity to respond to the AER's draft decision paper on forecasting productivity growth for electricity distribution network service providers (DNSPs). PIAC strongly supports the AER's decision to review its current practice of assuming zero productivity growth in distribution determinations. As noted in our submission the AER's issues paper on the NSW DNSPs 2019-24 determination, we do not consider this practice to be in the long-term interests of consumers.¹

The AER should address this concern by including a productivity forecast of at least 1.5% per annum in future distribution determinations.

The need for positive productivity forecasts in distribution determinations

As noted above, PIAC does not consider the inclusion of zero-productivity forecasts in distribution determinations to be appropriate. In PIAC's view, this practice:

- Does not meet consumer expectations;
- Is inconsistent with the goals of the regulatory framework; and
- Is not the best estimate given available information.

Consumer expectations

A zero-productivity forecast does not pass the 'sniff test'. Consumers expect DNSPs to find cost savings wherever possible, something the NSW DNSPs all heard during their recent consumer engagement programs.² In this context, consumers cannot accept that neither competition nor regulation requires DNSPs to find operational efficiencies over time.

¹ PIAC, [Submission in response to the NSW DNSPs 2019-24 regulatory proposals and AER issues paper](#), August 2018, 23.

² PIAC, [Submission in response to the NSW DNSPs 2019-24 regulatory proposals and AER issues paper](#), 3.

This has informed a united response to this issue from consumer advocates, including PIAC, Energy Users Association of Australia,³ Major Energy Users⁴ and the AER's Consumer Challenge Panel (CCP),⁵ all of whom support a positive productivity forecast in future distribution determinations.

Goals of the regulatory framework

Further, the current practice does not effectively promote the goals of the national electricity regulatory framework. A core goal of economic regulation of monopoly service providers (such as DNSPs) is to replicate the pressures these firms would face in a workably competitive market.

In such a market, firms are required to constantly reduce costs through productivity improvements or face losing market share and, eventually, going out of business. Therefore, it is not consistent with the overarching goal of the regulatory framework that DNSPs do not face a requirement to improve operational productivity. PIAC, and consumers, cannot accept this.

PIAC understands that some DNSPs consider the Efficiency Benefit Sharing Scheme (EBSS) to be sufficient to drive productivity improvements, and that including a positive productivity forecast will reduce the incentive on DNSPs to achieve these improvements. PIAC disagrees. While we support the application of the EBSS where appropriate, we consider it is a mechanism for sharing efficiency benefits beyond a baseline expectation of productivity growth. Under the AER's NPV = 0 approach to incentive-based regulation, PIAC contends that the expected value for EBSS should be zero. As stated by Endeavour Energy: "the EBSS should be expected to be negative as often (much) as it is positive".⁶ It is therefore necessary to include a baseline forecast for opex productivity growth to reflect the consumer expectations outlined above.

It has also been suggested that the inclusion of a positive productivity forecast in distribution determinations will reduce the incentive for DNSPs to become more efficient beyond that level. Again, PIAC disagrees. As noted above, the forecast should reflect a baseline expectation for productivity growth by DNSPs; the EBSS will continue to incentivise productivity beyond the baseline by allowing DNSPs to retain 30% of that benefit. Assuming that DNSPs are rational, profit-driven firms, PIAC does not see why they would not seek to access that benefit.

Best estimate given available information

Finally, a zero-productivity forecast in distribution determinations does not reflect the best evidence available to the AER. As noted in the draft decision paper, there is a range of available information that suggests positive productivity growth for DNSPs. This ranges from information about undergrounding assets (suggesting 0.5% growth) to multilateral partial factor productivity (MPFP) data (suggested 1.6% growth). That a range of data sources indicate positive productivity growth for DNSPs suggests that the current zero-productivity forecast is not the best estimate given available information.

The productivity forecast should be at least 1.5% p.a.

PIAC acknowledges the range of options presented by the AER for developing productivity forecasts, by using:

1. The status quo (zero productivity growth);
2. Productivity associated with undergrounding asserts (0.5% productivity growth);
3. Undergrounding productivity *and* gas distribution-based productivity estimates (1% productivity growth);

³ EUAA, [AER Forum NSW Distributors 2019-24 Revenue Determinations](#), presentation, November 2018, 6.

⁴ MEU, [Forecasting productivity growth for electricity distributors, Draft Decision Paper](#), submission, December 2018.

⁵ CCP, [Public Forum on Opex Productivity, 30 November 2018](#), public forum presentation, 30 November 2018.

⁶ Endeavour Energy, [Forecasting opex productivity growth factors](#), public forum presentation, 30 November, 2.

4. Industry average opex multilateral partial factor productivity (MPFP) growth, adjusted to remove catch-up (1.6% productivity growth);
5. Forecasts of labour productivity growth (0.9% productivity growth); or
6. A holistic approach that draws on all sources (1% productivity growth).

PIAC supports the AER using all available information to determine productivity growth forecasts. Therefore, we support option 6. However, we note that the output of this method depends on the relative weight applied to different data. While the AER suggests a holistic approach would derive a 1% productivity growth forecast, we understand that the CCP productivity sub-panel suggests giving the greatest weight to industry average opex MPFP and suggest a range of 1.5-3% productivity growth.

PIAC agrees with CCP that the AER should give the most weight to MPFP when using option 6. MPFP provides an unbiased estimate of the trend productivity growth in the electricity distribution sector:

- Exclusive of step changes;
- Reflective of the performance of utilities that are not materially inefficient; and
- Inclusive of trends in external factors that affect productivity but are not separately identified and included in the efficient opex estimates (e.g. standards creep).

In PIAC's view, these characteristics mean that MPFP data best suits the AER's objective in this review.

Therefore, we contend that the productivity forecast determined by this review should be *at least* 1.5% per annum, the lower bound of the CCP estimate using option 6 with the greatest weight given to MPFP.

The outcome of this review should apply immediately

In the draft decision paper, the AER proposes to implement the outcome of this review to its April 2019 determinations. PIAC supports this proposal. To delay implementation past these decisions would result in inefficiently high opex allowances for the relevant DNSPs, which is not in the long-term interests of consumers.

Continued engagement

PIAC would welcome the opportunity to meet with the AER and other stakeholders to discuss these issues in more depth, and looks forward to providing further detail on the issues explored in this submission. For further engagement please contact [Craig Memery](#).

Yours sincerely,

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