A fair comparison: PIAC submission to the Productivity Commission Inquiry, Electricity Network Regulation

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Bev Hughson, Darach Energy Consulting Services

Carolyn Hodge, Senior Policy Officer, Energy + Water Consumers' Advocacy Program

Level 7, 173-175 Phillip Street, Sydney NSW 2000 • DX 643 Sydney
Phone: +61 2 8898 6500 • Fax: +61 2 8898 6555 • www.piac.asn.au

Introduction

The Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit law and policy organisation that works for a fair, just and democratic society, empowering citizens, consumers and communities by taking strategic action on public interest issues.

PIAC identifies public interest issues and, where possible and appropriate, works co-operatively with other organisations to advocate for individuals and groups affected. PIAC seeks to:

- expose and redress unjust or unsafe practices, deficient laws or policies;
- promote accountable, transparent and responsive government;
- encourage, influence and inform public debate on issues affecting legal and democratic rights; and
- promote the development of law that reflects the public interest;
- develop and assist community organisations with a public interest focus to pursue the interests of the communities they represent;
- develop models to respond to unmet legal need; and
- maintain an effective and sustainable organisation.

Established in July 1982 as an initiative of the (then) Law Foundation of New South Wales, with support from the NSW Legal Aid Commission, PIAC was the first, and remains the only broadly based public interest legal centre in Australia. Financial support for PIAC comes primarily from the NSW Public Purpose Fund and the Commonwealth and State Community Legal Services Program. PIAC also receives funding from Trade and Investment NSW for its work on energy and water, and from Allens Arthur Robinson for its Indigenous Justice Program. PIAC also generates income from project and case grants, seminars, consultancy fees, donations and recovery of costs in legal actions.

Energy + Water Consumers' Advocacy Program

This Program was established at PIAC as the Utilities Consumers' Advocacy Program in 1998 with NSW Government funding. The aim of the program is to develop policy and advocate in the interests of low-income and other residential consumers in the NSW energy and water markets. PIAC receives policy input to the program from a community-based reference group whose members include:

- Council of Social Service of NSW (NCOSS);
- Combined Pensioners and Superannuants Association of NSW;
- Park and Village Service;
- Ethnic Communities Council NSW;
- Rural and remote consumers;
- Retirement Villages Residents Association;
- the Physical Disability Council NSW; and
- Affiliated Residential Park Residents Association.

The current review

The Australian Government has asked the Productivity Commission (the Commission) to undertake a public inquiry (the Inquiry) into aspects of national electricity network regulation.

PIAC welcomes the attention now being given to the critical issue of network regulation through the Commission's Inquiry and the parallel work by the Australian Energy Regulator (AER) and the Australian Energy Market Commission (AEMC) on changes to the National Electricity Rules (NER) and investigation of network reliability standards.[1]

The current *Electricity Network Regulation – Issues Paper* (Issues Paper) is the first stage of the public inquiry process.

The terms of reference for the Inquiry establish two streams of investigation:

- assess the use of benchmarking under the network regulatory framework and provide advice on how different benchmarking methodologies could be used to enhance efficient outcomes; and
- examine whether the regulatory regime is delivering economically efficient outcomes with respect to the delivery of interconnector investment in the National Energy Market (NEM).

PIAC's submission responds to the benchmarking stream of investigation.

General comments

The Commission has stated its intention to assess the extent to which robust benchmarks of efficiency can be produced, whether the NER could be amended to better support regulatory benchmarking and the benefits that benchmarking might bring in setting more effective incentives, investment controls and reducing the scope for disputes.

PIAC supports this approach. We also urge the Productivity Commission to look closely at the recent studies by jurisdictional regulators and others into the relative efficiency of different Distribution Network Service Providers (DNSP).

For example, the NSW Independent Pricing and Regulatory Tribunal (IPART) conducted a study in 2010 into the productivity of state-owned corporations[2] using both total factor and partial factor productivity measures.

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1 For example, the current AEMC reviews of (a) the rule change proposals submitted in November 2011 by the AER and the Energy Users Rule Change Committee, and (b) the electricity distribution reliability outcomes and standards.

2 Independent Pricing and Regulatory Tribunal, *Review of the Productivity Performance of State Owned Corporations*, IPART, 2010. Also see IPART's submission to the Draft Energy White Paper, IPART, *Strengthening the Foundation for Australia's Energy Future,* 2012.

Its finding of declining productivity performance on both total and partial productivity measures has been supported by research conducted by Mountain in 2011[3] which found that NSW DNSPs were incurring operating and capital expenditure costs per customer well above those of other jurisdictions. At the same time, relative efficiency was declining and service reliability was effectively static.

The task of network regulation reform must be a priority

PIAC believes that an urgent and coordinated response from the regulatory authorities is needed to address the mounting financial pressure on many households and small businesses as a result, in part, of the recent series of rapid increases in network charges. The need for urgency is heightened by the fact that network costs presently account for over 50% of NSW regulated retail electricity prices.[4]

While we acknowledge the new focus by regulators and governments on the issue of network price regulation, we are also aware that regulatory reform can be a slow and relatively tortuous process.

It is PIAC's view, therefore, that action must commence immediately to provide a balance between the interests of DNSPs and consumers. This is particularly true for NSW, given that the AER has already commenced the NSW network pricing determination process for the 2014-15 to 2018-19 regulatory period.

It would be unacceptable for the allowed network revenue path in 2009-10 to 2013-14, which has driven such steep annual increases in network charges in NSW, to be repeated for a further five years.

The reasons for urgency on this matter are further illustrated below and highlight the very negative impacts of the current situation on consumers and the broader economy.

The impact of network pricing on households

The announcement by IPART in April 2012 that electricity prices to residential customers in NSW will increase by an average of 16.4% from 1 July 2012 states that approximately half of this increase is due to increases in NSW network charges.[5] The 2012-13 increases in NSW network charges build on more than five years of network price increases substantially above CPI.

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3 Bruce Mountain, *Australia's rising electricity prices and declining productivity: the contribution of the electricity distributors* 2011, Energy Users Association of Australia.

4 IPART, *Updating regulated electricity price increases for 1 July 2012*, (Fact Sheet, December 2011).

5 IPART, *Electricity Prices Rise in NSW, Due to Higher Network Costs and the Introduction of the Carbon Price. (*Media Release 12 April 2012).

IPART has highlighted that over the last five years, the network cost component of retail electricity bills has increased by 72% (cumulative) in real terms, that is, a 72% increase above the increase in inflation (CPI).[6]

IPART also noted that the biggest increase in network charges has occurred in the last three years, 2009-10 to 2011-12.[7] These three years are the first years of the current 5-year network regulatory period, and the first that have been determined by the AER and subject to the National Electricity Rules (NER).

The current network revenue price path will ensure that these network charges will continue to grow (on average) through the last two years of the current determination period (to 2014-15).

As stated in the 2011-12 NSW Budget Statement:

> The capital expenditure of network businesses over the remaining three years of the regulatory period to 2012-14 will increase their regulatory asset base by around 40 per cent. As the asset base grows, earnings of the network business will increase because the regulated revenue includes a return on assets.[8]

The broader economic impact of network price increases

The cumulative increase in network charges has had a negative impact on productivity levels in the electricity industry, and across the economy more generally, drawing investment dollars away from other productive activities.

In NSW for example, the 2011-12 Budget Statement indicates that the increased capital expenditure that is driving much of the increase in network prices has also directly added some $10 billion to NSW net debt.[9]

Network capital expenditure is forecast to rise to $16.5 billion over the four years from 2011-12.[10] In the same period, forecast net debt in the network businesses will rise from $15.3 billion to $25.8 billion and gearing from 68% to 76%, adding further pressure to the state's overall financing position despite increased revenues to the network, and consequential increases in dividends and payments to the state.[11]

While the NSW Government considers the increase in net debt and gearing by the network companies is 'sustainable'[12], it nevertheless highlights the impact that the significant

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6 IPART, *Changes in regulated electricity retail prices from 1 July 2012, Electricity – Draft Report,* April 2012, 80.

7 Ibid, 80.

8 NSW Government, *NSW Budget Paper No. 2 2011-12 Budget Statement, (2011) Chapter 8, Public Trading Enterprises*, 13.

9 Ibid, 14 &16.

10 Ibid, 13.

11 Ibid, 14.

12 Ibid.

increases in network expenditure can have on the broader state economy, including potentially restricting expenditure on other services.

Therefore, the great importance of quickly putting in place effective regulatory and performance measurements that, together, will ensure that proposed capital expenditure (and operating expenditure) are at maximum efficiency for the required service levels.

Understanding the cumulative nature of network prices increases

In assessing the various contributions to increases in electricity prices, it is essential to highlight the different impacts of cumulative real increases in network prices compared to, for instance, a one-off price impact such as the carbon price.

For illustration of this point, ***Figure 1*** indexes network and carbon costs (in nominal dollar terms) from the start of the current NSW regulatory period.

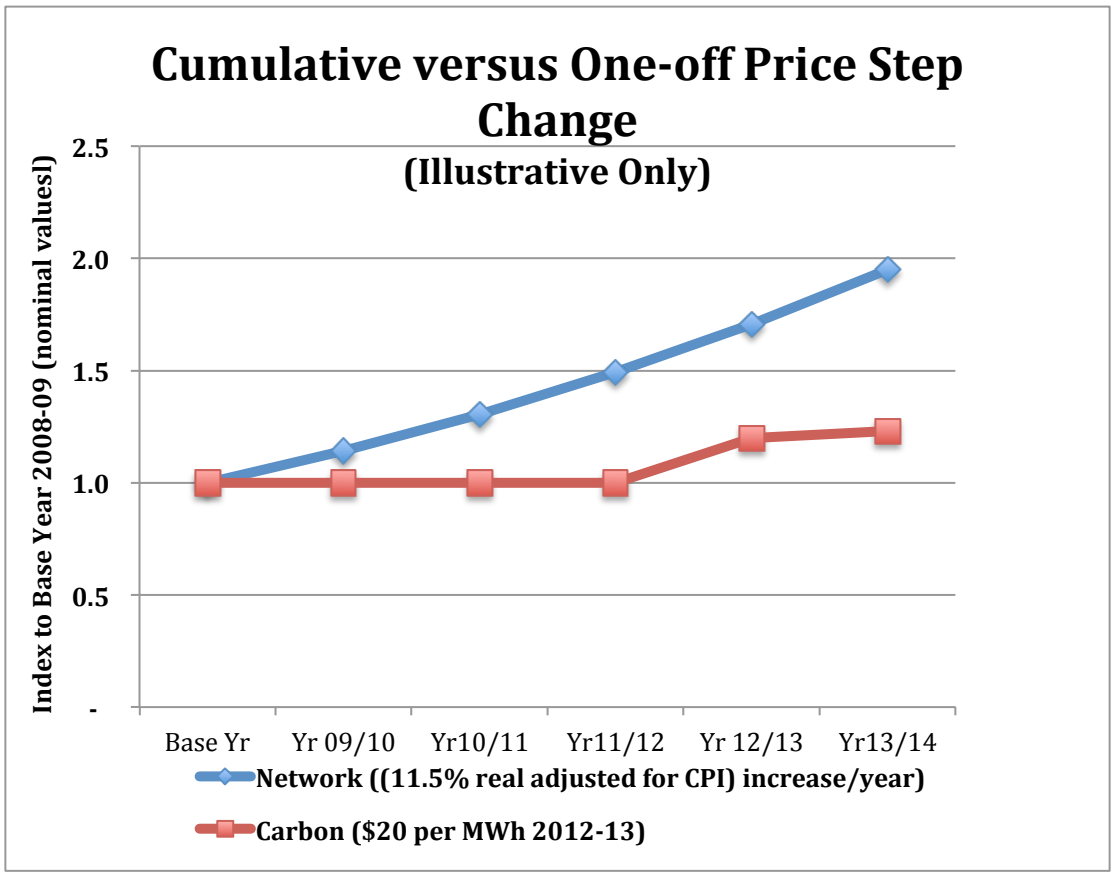

Figure 1. *Cumulative versus one-off step price change (Illustrative only)*

1. Although the chart is illustrative only, it is based on a smoothed network price path (11.5% per annum real, adjusted for annual CPI of 2.5%) that over the five years would match the 72% cumulative real increases in network prices over the last five years that was identified by IPART.[13]
2. The carbon price increase of $20/MWh in 2012-13 was based on $23/tonne of CO2 (increased by CPI of 2.5% in 2013-14). The carbon cost in $/MWh assumes an average carbon intensity factor of

[13] IPART, above n 6, 80.

0.87 and has been used by both IPART and the Queensland Competition Authority in their respective calculations of retail prices for 2012-13.[14]

The carbon price will cause a one-off real increase in wholesale electricity costs, but following that will not drive a further real price increase in 2013-14 as the regulated price increases only by CPI. In contrast, the network price increases illustrated in the chart compound each year. A household that was paying $600 in network charges in 2008-09 would be paying $1,170 (nominal) in network charges by 2013-14.[15]

In addition, network price increases that are driven by capital expenditure will flow through to future network price determinations.

This is because capital expenses (including any additional capital that was spent in excess of the allowed capital expenditure in the determination) are rolled into a DNSP's opening regulated asset base (RAB) for the next determination period[16] and the DNSP will receive a return on that asset over its full life cycle (at its depreciated value).

Given the short and long term impacts of network price increases at both the household and broader economy levels, implementing actual reform in network pricing processes must be a priority for all regulatory bodies.

In PIAC's view, developing a robust benchmarking approach to assist the AER in assessing operating efficiency and determining capital and operating costs is a key element of this reform process.

Benchmarking network performance is a key component of effective reform & the process should commence

The Issues Paper provides a comprehensive overview of the many regulatory and practical complexities involved in establishing a robust benchmarking framework.

PIAC's submission does not address all of the issues raised by the Commission with benchmarking. However, PIAC recognises the importance of the process and the need to develop valid and reliable benchmarks that can drive efficiency and other performance improvements.

It should also be accepted that there may never be a perfect set of benchmarks available to the regulator. A benchmarking framework, supported by a balanced set of robust benchmarks, can only develop over time and with experience. It will require a strong

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14 Ibid, 27 & Queensland Competition Authority, *Draft Determination - Regulated Retail Electricity Prices 2012-13,* 2012, 33.

15 Based on a real compound price increase of 72% over the period (11.5% per annum) adjusted for compound CPI of 2.5%, leading to a nominal compound increase over 5 years of 95%. Network charges make up some 51% of a household's electricity bill.

16 National Electricity Rules, Ch 6, cl 6.5.1 and sch 6.2.

commitment and a process that combines stability with flexibility to respond to changing circumstances and priorities.

However, there is a risk that the very complexity of the benchmarking process and a search for perfect data and methodologies could lead to "paralysis by analysis" when what is most needed is to make a start, however imperfect, with the process. This start could involve setting benchmarks for items and services that are easily comparable.

While PIAC is advocating a swift response, it is also mindful that this response should be reasonable and practical. If the availability of data is limited, the response to this argument should be to start collecting the relevant data.

It is also reasonable that the quality of the data and methodologies should influence how the AER proposes to use the benchmarks. For instance, it would not be appropriate to impose significant penalties or rewards on a business while the data quality is still questionable.

In PIAC's view, the identification of stumbling blocks is useful in identifying areas for progressive improvement but they should not constrain embarkation on the process of developing a benchmarking framework.

It can also be expected that some stakeholders will find multiple reasons why comparison benchmarking is not fair and should not be used.

These concerns have some validity and must be acknowledged. Again, however, the concerns should not delay the process of developing and progressively applying a balanced suite of benchmarks in the regulatory process.

The industry already has extensive experience with reporting on reliability measures such as System Average Interruption Duration Index (SAIDI), System Average Interruption Frequency Index (SAIFI) and the Momentary Average Interruption Frequency Index (MAIFI)[17] and the AER is progressively incorporating these measures into a national Service Target Performance Incentive Scheme (STPIS) to apply in the next determinations.[18]

Jurisdictional regulators have also collected various performance measures as set out in the distribution licences. Although these vary from state to state, they provide an extended history of DNSP operational performance.

The types of benchmarks used by IPART (2010), Mountain (2011) and The Brattle Group (2012), are cited throughout this submission. PIAC believes that the type of measures

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17 The Victorian network determination includes these measures as part of the Service Target Performance Incentive Scheme.

18 The AER indicated in its 2009 NSW determination that it will introduce the scheme in NSW from 2014-15. (See AER, *Final Decision New South Wales distribution determination 2009-10 to 2013-14,* 2009, 244).

used by these parties, together with some consolidation of measures already used by the AER in their various determinations and the existing state-based performance measures represent a very useful starting point.

To ensure a balance between the interests of DNSPs and consumers it is also important to improve the engagement of consumers in processes that affect network pricing, including, but not limited to, benchmarking processes. As the end-users of this essential service, only consumers can decide, for instance, on the appropriate trade-off between higher costs and higher reliability standards.

The United Kingdom energy regulator, the Office of Gas and Electricity Markets (Ofgem), is including an assessment of a network company's consumer engagement strategy as part of their incentive scheme for the fourteen DNSPs. Consumers also directly engage with and advise Ofgem (as a 'critical friend') during the regulatory price setting process through a 'Consumer Challenge Group'.[19]

Recommendations

PIAC recommends that a robust benchmarking framework be developed.

PIAC recommends that the process of developing a benchmarking framework begin without delay so that data which are currently available may be transparently compared in the upcoming NSW Network Price Determination.

PIAC recommends that a process of continuous improvement be a feature of the benchmarking framework's development. This process should include methods to identify data limitations and practical systems to collect relevant data.

PIAC recommends that the process of developing a benchmarking framework should be consultative and include opportunities for effective consumer engagement.

How did we get here & where can benchmarking fit in?

There are three factors that DNSPs have commonly referred to in explaining the rapid and continued increase in network charges. They are:

- demand growth, particularly growth in peak demand;
- ageing network assets that have entered a replacement cycle; and
- stricter reliability and other performance standards imposed through distribution business licences.

The degree to which these three factors impact the determinations by the AER in different jurisdictions will vary.

[19] See for instance, Office of Gas and Electricity Markets (UK) *Open letter consultation on the way forward for the next electricity distribution price control review – RIIO – ED1,* 6 February 2012, 5.

There appears to be a shortage of empirical analysis quantifying the relationships between these factors and the DNSPs' proposals for expenditure. Mountain, for instance, has queried whether, on a comparative performance analysis, there is any observable relationship between peak demand growth and capital investment.[20]

In any case, these explanatory factors do not of themselves demonstrate that the quantum, efficiency and effectiveness of the new capital and operating expenditure to address these issues are optimal or at best practice levels.

Certainly, the recent empirical studies (cited in this submission), which raise questions about the relative effectiveness and efficiency of past network expenditures, need to be fully considered.

Benchmarking, appropriately applied, provides an opportunity to shed some light on the questions of efficiency and effectiveness and the regulatory response to this. Some initial highlights are discussed below.

The current regulatory framework and the role of benchmarking

Under the NER the AER is obliged to use benchmarking as one of 10 criteria in deciding whether it is satisfied with the capital and operating expenditure proposals put forward by a DNSP for their five year revenue requirements.[21]

However, there appears to be some constraint in the practical use of benchmarking, particularly with respect to capital investment. For example, the AER has accepted expenditure claims even when its expert advisors suggest the costs are excessive.[22]

In making this observation, however, PIAC is also cognisant of some very real regulatory constraints that are facing the AER. The key issues appear to be the following:

- The general approach, known as the Propose-Respond model, which requires the AER to accept a DNSP expenditure or forecast proposal unless it can establish (a) the proposal is not 'reasonable', and (b) the AER can fully substantiate an alternative proposal;[23]
- The AER is required to recognise any capital over-spend in one regulatory period as part of the opening RAB in the following period, without assessment of its prudence or efficiency;[24]

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20 Bruce Mountain, as above n 3, 2011, vii – viii.

21 NER, as above n 16, ch 6, cl 6.5.7 (e) and cl 6.5.6 (e) (for capital and operating expenditure respectively).

22 For instance, the AER accepted Ergon Energy's proposed 2007-08 operating costs as representative of an 'efficient base year' despite their own, and their consultant's views that the costs were excessive. See AER, *Queensland Draft Determination 2010-11 to 2014-15*, November 2009, 157.

23 Following appeals by the Victorian distribution businesses, the final decision of the Tribunal suggests that both elements of proof (ie (a) and (b)) are required before the AER can impose its own decision on a 'reasonable' cost. See Australian Competition Tribunal, *Application by United Energy Distribution Pty Limited* [2012] ACompT 1 (6 January 2012) at [666-667].

24 NER, as above n 16, sch 6.2, cl 6.2.1 (c)(2) and (e).

- The Merit Review process, which allows a DNSP to seek review of any individual component of the AER's determination by the Australian Competition Tribunal (the Tribunal). As the review is limited to the specific grounds of appeal, the Tribunal cannot initiate a full de novo review – that is, it cannot review other components of the determination nor consider the impact of the decision on the whole determination outcome and the resulting network charges.[25]

It seems a real flaw in the regime that a DNSP's proposal for capital expenditure is carefully analysed by the AER (albeit with constraints) in the determination process. However, scrutiny by the AER of any subsequent overspends when setting the opening RAB for the next regulatory period, is not allowed under the Rules.

The Rule Change proposed by the AER, which sets a prescribed amount of over-spend (60%) that can be recognised in the RAB, is one approach to addressing the issue.[26] Although the AER's proposal accommodates adjustment for special circumstances, the AEMC and others consider setting a specific percentage figure might prove too rigid and not allow refinement over time, nor address the parallel issue of the timing of capital expenditure in a regulatory period.[27]

The AEMC has, however, indicated its support for the principle of constraining capital overspend, and will 'explore' a range of other options to deal with the issues.[28]

The changes recommended by IPART for an ex-post review of capital expenditure[29] also raise issues, particularly if the AER has to assess the overspent capital in the same way, and under the same type of rules and appeal processes as the ex-ante capital expenditure proposals.

In PIAC's view, this regulatory triangle has therefore created a 'perfect storm.' It clearly restricts the scope and discretion of the AER while potentially rewarding a DNSP that over-spends its capital allowance – a situation more likely to arise where a DNSP's cost of capital is significantly lower than the allowed cost of capital. The recent work by Mountain & Littlechild,[30] more recently, Mountain[31] provides some interesting empirical support to these general concerns, using relatively simple benchmark metrics as noted previously.

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25 National Electricity Law, s 71 R (1).

26 AER, *Rule Change Proposal, Economic Regulation of Transmission and Distribution Network Service Providers, AER's proposed changes to the National Electricity Rules,* September 2011, 19. The Rule Change proposal was joined by the Energy Users Association of Australia, Rule Change Committee.

27 AEMC, *Directions Paper, National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2012, National Gas Amendment (Price and Revenue Regulation of Gas Services) Rule 2012,* 2012, iv.

28 AEMC, *Information Sheet, Network regulation rule changes directions paper*, 2012, 2.

29 IPART, *Strengthening the Foundation for Australia's Energy Future, IPART's submission to the Draft Energy White Paper,* 2012. 6.

30 Bruce Mountain& Stephen Littlechild, 'Comparing electricity distribution network revenues and costs in New South Wales, Great Britain and Victoria', *Energy Policy,* vol. 38, 2010, 5770-82.

31 Bruce Mountain, as above n 3.

Mountain's 2011 study, for instance, found that the RAB for government-owned networks will be some three times that of the privately-owned networks by the end of the current regulatory periods.[32]

Mountain attributes this outcome to the substantial increases in annual capitalised expenditure per connection by the government-owned DNSPs (almost three times greater than the private sector DNSPs by 2014).[33] He further argues that such differences cannot readily be explained by control factors such as customer density,[34] demand growth or ageing assets.[35]

It will be over two decades before the impact of this rapid expansion of the RAB washes through the regulatory processes, and it will therefore be reflected in prices to consumers for many years, even if new network capital investment stabilises in the next regulatory period.

Highlighting the potential benefits of multiple approaches to benchmarking, Mountain (2011) also conducted a regression analysis to assess both relative efficiency and changes in efficiency of the DNSPs across the three regulatory periods. The regression analysis indicates:

- NSW & Qld (state-owned) DNSPs were declining in both relative and absolute efficiency across the three determination periods; and
- Victorian and SA (privately-owned) DNSPs remained at about the same level of efficiency across the three periods.[36]

IPART's 2010 productivity review of NSW State Owned Corporations also identified a significant decline in productivity in the NSW DNSPs between 2001-02 and 2008-09, using a Total Factor Productivity (TFP) analysis and a variety of output measures.[37]

While a decline in TFP might be expected given the higher levels of capital investment, IPART's study found that TFP still declined after excluding the return on capital component in the revenue allowed.[38] IPART also observed a decline in partial factor productivity (PFP) measures such as labour productivity of between 27% and 29%.[39]

In the same study, IPART found that the NSW transmission company, Transgrid, (which faced similar challenges and rapid increases in expenditure) experienced a decline in TFP. However, in contrast to the DNSPs, Transgrid also demonstrated improvements in PFP, for instance, labour productivity increased by 52%.[40] While there may be good reasons for

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32 Ibid, 28.

33 Ibid, 28.

34 Ibid, 27-28.

35 Ibid, 35-43.

36 Ibid, 32.

37 IPART, *Review of the Productivity Performance of State-Owned Corporations*, 2010.

38 Ibid, 52-53.

39 Ibid, 55.

40 Ibid, 47.

this difference, nevertheless it demonstrates that even fairly standard efficiency benchmarks such as TFP and PFP can lead to useful questions about comparative performance.

The impact of reliability standards

Reliability standards have to date been set by each state jurisdiction. PIAC understands that the use of deterministic standards in NSW, which focus on enforcing rigid input standards, rather than output standards, has also led to higher costs and less flexibility to respond to changes in demand characteristics.[41]

It is a positive development, therefore, that governments, regulators and the Productivity Commission are looking at this issue now with some focus on understanding the consumer perspective on the trade-off between costs and reliability.

It should be noted that estimating the willingness to pay for reliable supply of electricity is complex. In a submission to the AEMC *Review of Distribution Reliability Outcomes and Standards – NSW Workstream*, PIAC urged the AEMC to translate technical information and high-level concepts into information that is accessible to the consumers being consulted in processes aimed at estimating NSW customers' willingness to pay for distribution reliability.[42] Access to this kind of information increases people's ability to provide quality feedback on the standard of service they require; and the costs they are willing to meet to achieve them.

Again, however, PIAC urges the importance of this process reaching outcomes in time to allow conclusions to feed into the next NSW network price determination.

International benchmarking developments

The Brattle Group report to the AEMC has provided an extensive review of regulatory practices and outcomes in a number of jurisdictions around Australia and the world, noting that it is used for both tracking performance and, in some cases, included in an incentive scheme.[43]

With respect to broader measurements of a DNSP's performance, the progressive development of the regulatory framework in the United Kingdom, provides insights into how benchmarking can be used to achieve enhanced revenue, efficiency and customer-service outcomes.

Ofgem has recently commenced a public consultation process for the next distribution price control review (RII0-ED1) due to start in April 2015.

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41 IPART, as above n 6, 84.

42 Public Interest Advocacy Centre, *Submission to the AEMC Review of Distribution Reliability Outcomes and Standards – NSW Workstream,* 2011, 2 <www.piac.asn.au/publication/2011/12/review-distribution-reliability-outcomes-and-standards>.

43 The Brattle Group, *Approaches to setting electric distribution reliability standards and outcomes,* 2012, 9.

Most relevantly, in their initial open letter to stakeholders, Ofgem proposes:

> We will be looking to adopt a toolkit approach for assessing the efficient costs in the companies' business plans. This will be similar to the approach used for RIIO-T1 [the current determination] and will involve a range of different levels of analysis. There are a number of key issues that we will need to address, such as developing totex analysis (ie comparable analysis of high level costs), the assessment of innovative solutions of the avoidance of investment, determining appropriate cost drivers, regional factors and the treatment of insourcing versus outsourcing.[44]

Ofgem also sets out its expectations regarding enhanced stakeholder engagement and how this will be introduced into the revenue incentive scheme from 2015.[45]

PIAC recognises that Ofgem operates under different regulatory rules that give it considerably more discretion to set efficient costs and impose incentive measures.

Nonetheless, PIAC considers that Ofgem's evolutionary approach to benchmarking, its proposal to use a 'toolkit' of measures and the investigation of various control factors is remarkably close to addressing the fundamental concerns of the AER, governments and community in Australia.

Conclusion

PIAC acknowledges that establishing effective benchmarks can be a complex process and must be approached with full understanding of the strengths and weaknesses of various aggregate and disaggregated measures.

PIAC also recognises that the current regulatory model may handicap the AER in using the full power of benchmarking to drive improvements in efficiency and lower relative costs to all end-users.

For this reason, PIAC supports the current Inquiry's investigation of the regulatory barriers to effective benchmarking including consideration of any amendments to the NER that might facilitate the AER's use of benchmarks to enhance more efficient outcomes.

However, we believe that NSW consumers cannot wait until the full regulatory change processes are undertaken.

There is an urgent need to commence the benchmarking process (within the current powers of the AER to collect information and use benchmarks) that will bring some rigour to network proposals and the evaluation of them by the AER in the forthcoming round of determinations.

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44 Ofgem, as above n 19, 3.

45 Ibid, 4.

PIAC believes the collection of such data will also assist the AER to support its views if or when a DNSP challenges the AER determination in the Tribunal, even within the current limitations of the merits review process.

Finally, we urge the Productivity Commission (and the AER and the AEMC) not to become too bound by the complexity of the details of benchmarking before taking some action.

PIAC commends the evolutionary approach adopted in the UK by Ofgem for the Productivity Commission's consideration. As highlighted above, Ofgem's approach uses progressively refined aggregate and disaggregated benchmarks to assess expenditure allowances and set efficiency and performance targets.

As a result, these benchmarks appear to have successfully driven significant cost reductions without reduction in network reliability or customer service standards. They are continually evolving to meet the changing market place.

PIAC is also very supportive of the extent to which Ofgem has proactively sought to involve customers in the process of benchmarking, establishing a clear framework of communication and negotiation.

We recognise that Ofgem's approach relies on a different regulatory framework that gives much greater discretion to the regulator. However, this too may provide insights into potential changes to the NER that address the issues identified by the Productivity Commission and others.