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Managing Director

Mr John Pierce
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Dear Mr Pierce

Re: AEMC draft Rule determination for the Total Factor Productivity for Distribution Network Regulation Rule Change Proposal

Ausgrid welcomes the opportunity to provide a submission on the AEMC draft Rule determination on the Rule change proposal submitted by the Victorian Minister for Energy and Resources to implement a total factor productivity (TFP) methodology for electricity distribution in Australia.

Ausgrid notes that the Commission has decided not to make a draft Rule as it was not satisfied that the proposed Rule (i.e. the TFP methodology) meets the National Electricity Objective (NEO). The Commission concluded that the necessary conditions to implement a TFP methodology are not present because a sufficiently robust and consistent data set to support TFP does not currently exist.

We note that the Commission, in its final TFP review report to the Ministerial Council on Energy (MCE), has recommended a rule change to initiate Rules for the collection of TFP data (TFP data collection Rules). This Rule would provide the AER with additional information gathering powers to those already included in the National Electricity Law and is a first stage in potentially introducing a TFP methodology.

Ausgrid agrees with the Commission that the pre-conditions for a TFP methodology have not been met. However, we do not agree that a case has been made that a TFP methodology could contribute to the NEO. In particular, we have concerns about the validity of the Commission's conclusion that a TFP methodology, as an alternative to the building block methodology, could be used for setting price or revenue paths at a level which is sufficient to cover costs and cope with changes in business or economic circumstances. We maintain that the Commission's own consultant (Economic Insights) was not able to provide conclusive evidence to support this conclusion. Moreover, there remain some unresolved issues with the modelling (particularly the theoretical limitations of the data used and the practicality of how to address differences in reliability performance or topography across businesses) and consequently the conclusions that can be drawn from this work.

Additionally, while we agree that a robust data set for TFP would be required, the decision to proceed with a data collection exercise before a definitive conclusion on the merits of TFP (and its ability to meet the NEO) is premature. A more pragmatic approach would have been to make a full assessment of the TFP methodology, design a model and then gather appropriate data to populate the model, rather than the current process where data collection is wide in scale and lacks clear focus.

Ausgrid (and other DNSPs) is currently subject to the AER's wide-ranging data and information gathering powers in the form of the Regulatory Information Notice (RIN). The RIN collects a range of standardised financial and non-financial information each regulatory year. If the TFP data collection Rules enter into force, businesses will be required to produce two sets of audited records and to potentially develop additional systems (not used for normal business purposes) to collect the data. This would result in significant cost, particularly as at least 8 years of robust and consistent data will be required for a TFP dataset.

We also note that the TFP data collection Rules state that the AER may potentially use historical (back-cast) data. We strongly disagree with this proposal as the inappropriateness of currently available data was well established and beyond doubt in the final TFP review report. As back-cast data cannot be used to support TFP, it should be excluded from the TFP data collection Rules.

In any event, there is no certainty that TFP would ever be appropriate for the Australian economic regulatory framework or that all businesses (if any) would apply TFP if it becomes available as an alternative regulatory method. Many distributors (including Ausgrid) have already expressed concern that the AER use of RIN information for benchmarking (under the building block approach) is extracting too far away from individual business circumstances. TFP would arguably go even further.

In conclusion, Ausgrid is disappointed with the approach adopted by the Commission where it developed the proposed TFP data collection Rules without consultation from stakeholders. This lack of transparency seems inconsistent with a central goal of the TFP methodology which is to promote transparency. It is important that the Commission ensures that the scope and content of the TFP data collection Rules be tightly and transparently prescribed and that a regime exists to protect the confidentiality of the data provided.

Ausgrid will provide a detailed submission pending the MCE's decision on the final TFP report. If you have any queries or wish to discuss this matter in further detail please contact Mr Keith Yates (Acting/ Executive Manager Regulation & Pricing) on (02) 9269 4171.

Yours sincerely



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