



23 November 2012

Philip Weickhardt  
Commissioner  
Productivity Commission  
By email: [electricity@pc.gov.au](mailto:electricity@pc.gov.au)

Dear Philip,

Thank you for the opportunity to provide the EUAA's perspectives on the Productivity Commission's Draft Report on its Review of Electricity Network Regulatory Frameworks.

We commend the Commission on its Draft Report. We found the analysis in the Report thorough and well considered. We support almost all of the main points in this Report, and commend it to policy makers. If policy makers heed the recommendations in this Report, this will deliver substantial improvements that will be in the long term-interest of consumers.

In the rest of this letter we comment on the Commission's discussion of benchmarking and also suggest areas that the Commission might consider further in the finalisation of its Report.

Firstly, we wonder whether the Commission has unintentionally undermined the potential contribution of benchmarking, by setting a higher "burden of proof" for the use of benchmarking analyses, than it has for bottom-up forensic assessments.

The efficient level of expenditure by network service providers is not knowable with certainty, ex-ante. This is because technologies and processes change and this affects efficiency in ways that can not be predicted with certainty. As such the objective in setting "efficient" expenditure allowances is to reduce the prospect of excessive errors (whether too little or too much) rather than to claim that the "efficient" level of expenditure has been found.

Recognising that perfection in the ex-ante analysis of efficiency is unachievable - whether through benchmarking approaches or forensic cost assessments - creates context for the evaluation of the contribution of benchmarking in assessing expenditure allowances. The fallibility of benchmarking with existing incomplete datasets and methodological immaturity needs to be set against the observation that rectifying such shortfalls does not necessarily

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provide any greater certainty that the “efficient” expenditure allowance can be determined. In addition, concerns about the greater use of benchmarking at this point, needs to be set against the errors intrinsic to the exclusive use of forensic bottom-up assessments, as the Commission has recognised.

Second, we think it would be helpful if the Commission considered in greater detail, the impact of state governments’ receipt of income taxes, and debt guarantee fee income, from the NSPs they own. Our contention is that these additional sources of income have distorted investment incentives and encouraged government-owned NSPs to spend more capital than they should have. It would be helpful for the Commission to advise on changes to the regulatory regime that might deal with this, even in the absence of its preferred solution of privatisation.

Third it would be helpful if the Commission brought-forward recommendations on the design of the regulatory regime for government-owned NSPs that will ensure that consumers are better protected against errors in the determination of expenditure allowances and the cost of capital. Our observation is that the arrangement of five yearly price controls has locked in significant errors – such as excessively high demand forecasts and estimates of the cost of capital. Energy users are paying the price of these errors.

Shorter regulatory periods would mean that these errors could be addressed sooner. We appreciate that this undermines the efficiency incentives that fixing prices/revenues are intended to deliver. However, we are sceptical that this will necessarily be a significant detriment, for government-owned NSPs where the evidence seems to suggest that efficiency incentives have not worked as it was asserted they would.

Fourth, we think that it would be helpful if the Commission gave greater consideration to the arrangements for consumer engagement in economic regulation, with particular regard to the scope for negotiated settlements in the regulation of NSPs.

We would be pleased to discuss any of these points with the Commission in greater detail if this would be helpful.

Yours sincerely,

Brian Green  
Chairman