

E.F



RECEIVED  
20 JAN 2012

16 January 2012

Mr John Pierce  
Chair  
Australian Energy Market Commission  
PO Box A2449  
SYDNEY SOUTH NSW 1235

**George Maltabarow**  
Managing Director  
  
570 George Street  
Sydney NSW 2000  
All mail to GPO Box 4009  
Sydney NSW 2001  
T +61 2 9269 2112  
F +61 2 9264 2982  
[www.ausgrid.com.au](http://www.ausgrid.com.au)

Dear Mr Pierce

Ausgrid has reviewed the submissions made to the AEMC as part of the consultation process on the AER and EUC Rule change proposal, and given the analysis of interstate comparisons over price, costs and asset remaining lives in some of these submissions it is necessary for Ausgrid to respond to these issues at this time.

**Interstate comparisons over price**

Information surrounding historical and future prices is very much dependant on the assumptions used. Electricity prices can vary significantly within states depending on which electricity distribution area a customer is located in, so averaging information across states may tell you little more than the differences between each state.

The average price paid by a customer can also vary depending on their price plan (inclining block, time-of-use and controlled load), whether they are on a market contract and the amount of usage in various tariff categories.

Electricity distribution costs represent only a part of the total mix of costs that make up what a consumer pays for energy. Our comparative analysis of energy prices between Sydney and Melbourne (attached) suggests that when total energy costs (electricity and gas) are taken into consideration, it is estimated that a typical residential dual fuel customer in Melbourne pays more on their energy bills, by about \$100 per year, than a typical dual fuel customer in Sydney.

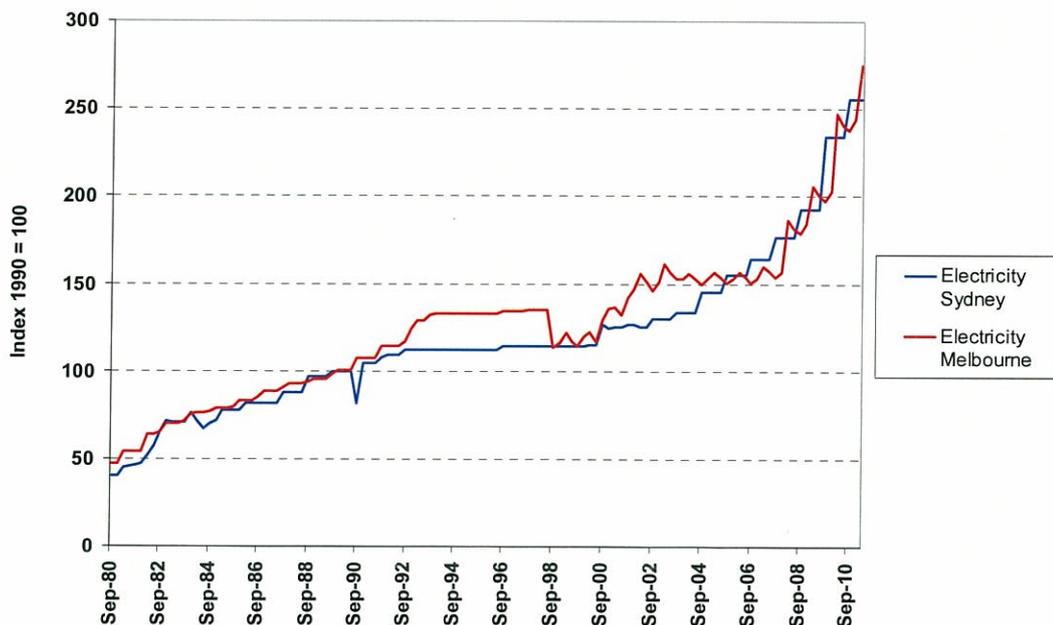
This is despite:

- gas prices being over 30% more expensive in Sydney than Melbourne; and
- gas comprising a higher proportion of overall energy in Melbourne. The ABS estimates that 92% of Melbourne households and 46% of Sydney households are connected to mains gas supply.

Our analysis found that a typical electric-only household in Sydney with an off-peak hot water system has the lowest total energy bills due to the cheap off-peak tariff for hot water and not having to pay the service charges for a gas connection.

Over the longer term official measures of consumer electricity prices in Sydney and Melbourne have been generally consistent. The ABS Consumer Price Index statistics for electricity prices shown below indicate a broadly similar trend of price rises over the longer term, interspersed with periods of divergence.

**Sydney and Melbourne Electricity CPI**



The AEMC should be cautious in accepting conclusions based on high level analysis on state comparisons.

### **Interstate comparisons over costs**

Similarly, analysis that seeks to compare cost outcomes between states based on high level benchmark metrics should also be considered with caution.

The broad operating context in which Distributors operate have quite different characteristics that influence the price paid by customers. For this reason, benchmark indicators can be misleading because they do not properly take into account the different drivers of network costs.

For instance, NSW distributors operate under different licence conditions than Victorian distributors, particularly in respect of reliability of supply to the CBD. The AER recently published data which showed that NSW customers receive a more reliable electricity service than customers in other regions. The number of interruptions experienced by an average customer in NSW in 2008-09 was 28 per cent lower than in Victoria, while the duration of interruptions was 44 minutes (or 17 per cent) lower in NSW compared to Victoria.

Due to differences in geography, measures that compare the costs of supplying an individual customer are likely to be highly unreliable. These measures are driven by customer density rather than the costs which are being benchmarked. There are 700,000 more electricity customers in NSW than Victoria spread across an area that is three times the size. About 55 per cent more electricity is consumed in NSW than in Victoria, while the peak demand is 40 per cent higher. The network area is also bigger in NSW, requiring an extra one million electricity poles and 120,000 km of electricity wires.

A DNSP with higher customer density will obviously appear more efficient on a cost per customer measure, reinforcing the limited usefulness of the measure itself. Similarly, a comparison of opex per square kilometre between NSW (\$1,569 per square km) and Victoria (\$2,305 per square km) would suggest NSW is more efficient, but in reality just reflects the diversity of geography between the two states.

There are other differences between networks that will drive differences in costs which cannot be eliminated from the analysis. This includes topography, network configuration, fuel mix and investment drivers and lifecycle, just to name a few. The replacement needs on our network represents a considerable point of difference with other network businesses.

We can reproduce significant evidence regarding our replacement investment program. Our proposal to the AER included substantial evidence regarding investment needs. Over 40% of Ausgrid's capital program is driven by asset condition and replacement need, compared to an average of around 15% for Victorian businesses. The AER and its consultant reviewed our capital program and determined a forecast capital allowance it considered was prudent and efficient. There is no evidence suggesting the AER was constrained in making its determination on replacement capex nor did the AER indicate that it was operating under any such constraint at the time.

### **Interstate comparisons of asset lives**

The Australian Energy Regulator has previously noted that a reasonable measure of replacement need is the proportion of the network which is over 90% of the asset life. The AER's engineering consultant reported that Victorian businesses on average had 3 to 5% of their networks in that category. In contrast at the beginning of this period 34% of assets on Ausgrid's network exceeded their asset life. In other words at the beginning of this regulatory period only 34% of the assets on the Ausgrid network were in a condition suitable for operation beyond the time at which one could expect them to be replaced.

Efficient asset management has allowed us to utilise these investments for a longer period of time, keeping expenditure (and prices) lower than they would otherwise have been. Any further

delay in infrastructure replacement would have compromised the reliability and safety of the network. Consequently, an uplift in our investment cycle began in 2005 and is likely to peak in this period, other things being equal.

User groups advocate using the remaining life of each asset class in the AER's Post Tax Revenue Model (PTRM) as a key consideration of determining future investment and replacement need. In our view, the PTRM remaining lives do little more than determine the remaining number of years that the assets will return a financial value (like the principal on a loan). It is a very poor indicator of replacement need because:

1. it ignores assets which have been fully depreciated in a financial sense, but whose condition allows them to continue to operate in a technical sense;
2. it is an average remaining life and is weighted by the annual historic cost of capex, so as costs increase with time the remaining life is more weighted by the cost of younger assets; and
3. the RAB value is based on historic cost values and does not represent the current cost of replacing assets that are in need of replacement.

Interstate comparisons of replacement need based on the remaining asset lives in the PTRM are of little relevance for asset management and determining replacement requirements.

Yours sincerely



**GEORGE MALTABAROW**  
*Managing Director*