AUSTRALIAN ENERGY REGULATOR

Draft decision: Ausgrid 2019–24

We have made a draft distribution determination for Ausgrid, the electricity distribution network operator for Sydney, the Central Coast and the Hunter Valley. Our draft decision would allow Ausgrid to recover $7940.4 million ($nominal) in revenue from its customers over five years commencing 1 July 2019.

Estimated impact on customer bills ($nominal)

The distribution network tariffs that will be set by reference to our final decision are only one contributor to electricity bills, and make up around 37 per cent of the total retail electricity bills Ausgrid's customers pay.

Holding all other components of the bill constant, the average annual electricity bill for a residential or small business customer on Ausgrid's network would be 2.6 per cent lower by the end of the 2019–24 regulatory control period.

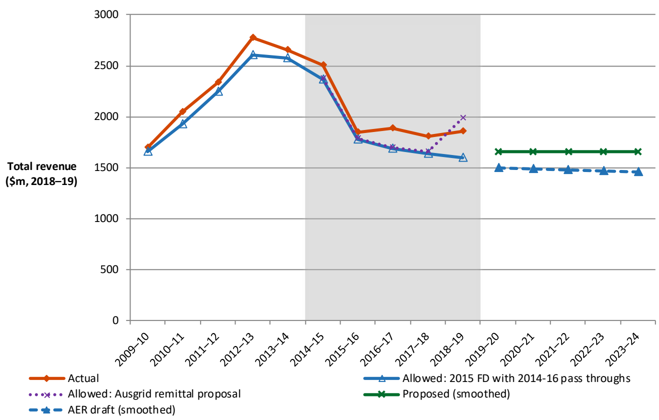
For Ausgrid's residential and small business customers, this suggests that the average annual electricity bill would be $44 and $104 lower, respectively, by the end of the 2019–24 regulatory control period.

Overview

We, the Australian Energy Regulator (AER), regulate Ausgrid’s revenue by setting the total revenue it may recover from its customers. Our draft decision includes revenue for Ausgrid’s distribution and dual function (transmission) assets.

Our draft decision allows for an 18.5 per cent real reduction in Ausgrid’s total revenue from the current period.

Ausgrid’s past and proposed total revenue and AER draft decision revenue allowance ($million, 2018–19)



Key elements of our draft decision

Ausgrid's proposal was made following a period of engagement with consumers on its plans to address consumer priorities of affordability, reliability and sustainability. As part of our agreement to extend the time for submission of its proposal from 31 January to 30 April 2018, this engagement included a series of 'deep dives' into elements of its proposal in early 2018. This level of engagement was a significant improvement on Ausgrid's engagement in past processes.

In a number of respects we agree with Ausgrid on the key drivers influencing its revenue requirement for 2019–24. However, our draft decision does not allow the total revenue proposed by Ausgrid. The total revenue in this draft decision is $978.0 million ($nominal), or 11.0 per cent, lower than in Ausgrid's proposal.

Part of this difference is because our draft decision includes a placeholder revenue adjustment for the difference between Ausgrid's revenue under interim price undertakings over the 2014–19 period and its proposed resolution of our remade decision for that period, which will be returned to customers in the 2019–24 period. This placeholder adjustment is based on Ausgrid's remittal proposal, which was submitted after its proposal for 2019–24. An adjustment of this nature was contemplated in Ausgrid's proposal for 2019–24, but not included in its revenue calculation at that time.

The remaining difference relates to areas in which our draft decision identifies concerns with Ausgrid's 2019–24 proposal, which we summarise below.

Ausgrid will now have the opportunity to respond to our draft decision in its revised proposal. We will continue to work with Ausgrid and stakeholders to ensure that our final decision, which will determine the revenue Ausgrid can recover from its customers for the 2019–24 regulatory control period, is in the long term interests of consumers and that Ausgrid's customers are paying no more than they should for safe and reliable electricity.

Next steps

Ausgrid’s revised regulatory proposal is due by 8 January 2019. Stakeholders may make written submissions on our draft decision and Ausgrid’s revised proposal by 5 February 2019. Our final decision is due for release by the end of April 2019.

Rate of return and gamma

The biggest contributor to the difference between our draft decision and Ausgrid's proposal is our proposed change to the rate of return (and therefore the return on capital). Our draft decision adopts the approach proposed in our draft 2018 rate of return guideline to calculate a 5.96 per cent rate of return. This is lower than Ausgrid's proposed 6.33 per cent, which was based on our 2013 guideline.

Also reflecting our draft 2018 rate of return guideline, our draft decision adopts a value of imputation credits (gamma) of 0.5 compared to Ausgrid's proposed 0.4, which has contributed to the reduction in the corporate income tax allowance relative to Ausgrid's proposal.

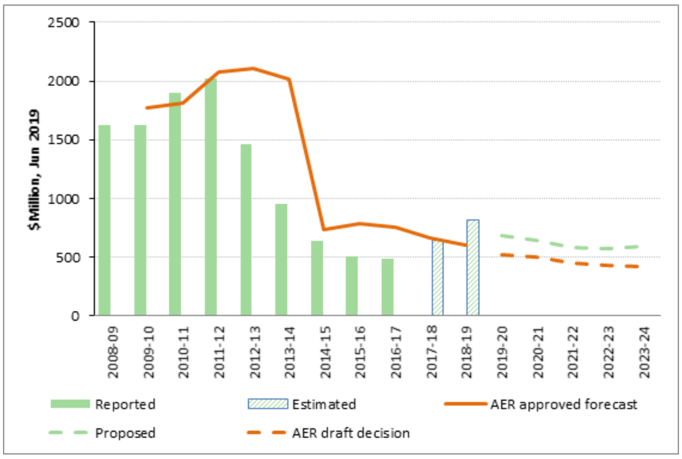
Consultation on our draft 2018 guideline is ongoing, and is expected to conclude in December 2018. Legislation before the South Australian Parliament at the time of this draft decision will (if passed) make our final 2018 rate of return guideline binding on this and other decisions.

Capital expenditure (capex)

Capex—the capital costs and expenditure incurred in the provision of network services—mostly relates to assets with long lives, the costs of which are recovered over several regulatory control periods. Capex is added to Ausgrid's regulatory asset base (RAB), which is used to determine the return on capital and return of capital (regulatory depreciation) building block allowances. All else being equal, higher forecast capex will lead to a higher projected RAB value and higher return on capital and regulatory depreciation allowances.

Our draft decision on Ausgrid's revenue includes total forecast capex of $2,209.8 million ($2018–19) for 2019–24.

Ausgrid's past and proposed capex and AER draft decision capex allowance ($million, 2018–19)



Our draft decision substitutes a capex forecast that is $755.9 million lower than Ausgrid's proposal.

Ausgrid's proposed capex included provision for a level of capital investment that we consider goes beyond what is efficient and prudent for the maintenance and operation of its network and given expected demand. The lower capex forecast we have substituted for the purposes of this draft decision has resulted in a lower projected RAB over the 2019–24 period than assumed in Ausgrid's proposal, and also a lower regulatory depreciation allowance.

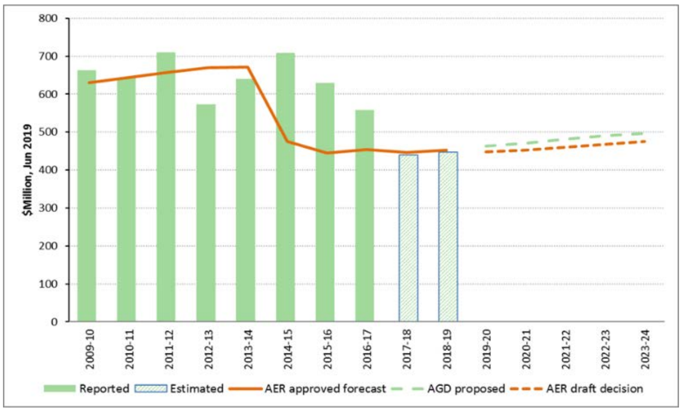
In its revised proposal Ausgrid will have the opportunity to address our concerns with its initial capex proposal, which was 25.5 per cent more forecast capex than we have included in this draft decision.

Operating expenditure

Opex is the forecast operating, maintenance and other non-capital costs incurred in providing network services.

Our draft decision is to include total forecast opex of $2,344.1 million ($2018-19) in Ausgrid's revenue for 2019-24. The total forecast opex in this draft decision is around 15.8 per cent lower than Ausgrid's opex in the current period.

Ausgrid's past and proposed opex and AER draft decision opex allowance ($million, 2018–19)



The total opex forecast we have included in this draft decision is $98.4 million lower than Ausgrid's proposed total opex forecast of $2442.5 million.

On the information before us, we consider Ausgrid has not justified the full extent of its proposed step changes in opex, and that its total forecast opex over-estimates the likely changes in the costs of labour and network growth. Between now and our final decision in April 2019, we will also be giving further consideration to our approach to forecasting productivity. This review may change our approach going forward, which in turn may impact our final decision on Ausgrid's opex.

For more information:

More information on Ausgrid's proposal, our draft decision and how to make a submission is on our website: www.aer.gov.au.