



DRAFT DECISION

AusNet Services Transmission Determination 2022 to 2027

Overview

June 2021

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Invitation for submissions

AusNet Services now has the opportunity to submit revised proposal by 2 September 2021, in response to our draft decision.

Interested parties are invited to make submissions on our draft decision (and when it is received, AusNet Services' revised proposal) by 5 October 2021.

We will consider and respond to all submissions received by this date in our final determination.

Submissions should be sent to: AusNetServices2022@aer.gov.au

Alternatively, submissions can be sent to:

Warwick Anderson
General Manager
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

We prefer that all submissions be publicly available to facilitate an informed and transparent consultative process. **We will treat submissions as public documents unless otherwise requested.** All non-confidential submissions will be placed on the AER's website. For further information regarding the AER's use and disclosure of information provided to it, see the ACCC/AER Information Policy, which is available on our website.¹

We request parties wishing to submit confidential information:

- clearly identify the information that is the subject of the confidentiality claim
- provide a non-confidential version of the submission in a form suitable for publication.

¹ <https://www.aer.gov.au/publications/corporate-documents/accc-and-aer-information-policy-collection-and-disclosure-of-information>

Review timeline

The key milestones for our review of AusNet Services' regulatory proposal are set out below:

Milestone	Date
<i>AusNet Services' submitted its proposal</i>	<i>29 October 2020</i>
<i>AER issues paper published</i>	<i>11 December 2020</i>
<i>Public forum on AusNet Services' proposal held</i>	<i>16 December 2020</i>
<i>Submissions on AER's issues paper and AusNet Services' proposal close</i>	<i>12 February 2021</i>
AER draft decision published	30 June 2021
Public forum on draft decision	5 August 2021
AusNet Services' submit revised proposal	2 September 2021
Submissions on draft decision and revised proposal close	5 October 2021
AER final decision to be published	31 January 2022

Note

This overview forms part of the AER's draft decision on AusNet Services' 2022–27 transmission determination. It should be read with all other parts of the draft decisions.

The draft decision includes the following attachments:

Overview

Attachment 1 – Maximum allowed revenue

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 11 – Demand management innovation allowance mechanism

Attachment 12 – Pricing methodology

Attachment 13 – Pass through events

Attachment 14 – Negotiating framework

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Executive summary

The Australian Energy Regulator (AER) works to make all Australian energy consumers better off, now and in the future. We regulate energy networks in all jurisdictions except Western Australia. Our work is guided by the National Electricity Objective (NEO) which promotes efficient investment in, and operation and use of, electricity services in the long term interests of consumers.² To achieve this, we set a maximum revenue that a network business is allowed to recover from its customers in providing network services. This revenue is based on our assessment of efficient costs and forecast electricity demand. By only allowing efficient costs we regulate network tariffs so consumers pay no more than necessary for the safe, secure and reliable delivery of electricity.

Victorian households and businesses consume electricity, which is supplied through a network of 'poles and wires'. The electricity network in Victoria is commonly divided into two parts:

- a transmission network, which carries electricity from the large generators to the major load centres
- distribution networks, which carry electricity from the points of connection with the transmission network to virtually every building, house and apartment in Victoria.

In Victoria, two separate organisations are responsible for the electricity transmission network—AusNet Services and the Australian Energy Market Operator (AEMO). Under this model, the transmission network planning functions in Victoria are separated from network ownership and operation.

AusNet Services is the transmission network service provider (TNSP) which owns and operates Victoria's electricity transmission network.³ It is responsible for transporting electricity from generation sources into Victoria's five lower-voltage distribution networks.

AEMO is also a designated TNSP and is responsible for planning and procuring the augmentation of the Victorian shared transmission network. Given that AEMO is responsible for augmentation investment and plans, these costs are not included in AusNet Services' revenue proposal.

On 29 October 2020, AusNet Services submitted its regulatory proposal for the five year regulatory control period commencing 1 April 2022.

Although our decision influences the total revenue AusNet Services can recover from its transmission customers, we do not set transmission charges for each customer or the retail prices that end consumers pay.

Retail prices are set by electricity retailers and include the costs associated with transmission, distribution, generation, and the costs incurred by retailers in selling the electricity. In Victoria, this also includes the recovery of the Victorian

² NEL, s. 7.

³ The relevant licensed entity is AusNet Services Transmission Group Pty Ltd (ABN 78 079 798 173).

Government's Easement Tax, which is recovered through AusNet Services' network tariffs.⁴

This draft decision sets out the amount of revenue AusNet Services can collect from electricity consumers for using its transmission network in the 2022–27 regulatory control period which runs from 1 April 2022 to 31 March 2027 (2022–27 period).

AusNet Services can recover \$2837.8 million (\$nominal, smoothed) from its customers in the 2022–27 regulatory control period. In real terms, this is 2.9 per cent lower than allowed for in our 2017–22 final decision. This is driven predominately by our forecast of lower return on capital and the cost of corporate income tax. The total revenue allowed in our draft decision is 1.6 per cent less than that proposed by AusNet Services.

The revenue we allow forms the transmission network component of retail electricity bills. In Victoria, transmission accounts for about 5.5 per cent of the total electricity bill, for a typical residential customer.

We expect to receive further information from AusNet Services in its revised proposal in relation to operating expenditure step changes. At the time of making this draft decision, we have used placeholder values of zero dollars where we did not have enough information to inform our assessment of efficient costs. In some cases, these placeholders are likely to increase significantly in our final decision. For example, we consider it prudent for AusNet Services to include a cyber security step change and further acknowledge AusNet Services will need to include a council rate step change for the 2022–27 regulatory control period. It is for this reason that we expect the bill impacts estimated in our final decision to be higher than this draft decision.

Based on our placeholder decision, we estimate that compared to current charges, AusNet Services' transmission network charges in the first year of the 2022–27 regulatory control period will rise by \$2 (0.1 per cent) for residential consumers and \$7 (0.1 per cent) for small business consumers. Thereafter, charges will increase by an average of \$1 (0.1 per cent) and \$4 (0.1 per cent) each year over the remaining four years of the regulatory control period for residential and small businesses consumers, respectively.

We estimate these bill impacts by calculating the average revenue per unit of energy charged to customers under our determination. We have adopted standard assumptions about the amount of energy used by customers and hold all other bill components constant. These estimates will vary between our draft and final determinations following additional information provided in response to our draft decision.

We have had regard to a range of sources in making this draft decision, including AusNet Services' proposal and additional analysis undertaken and published by us.

AusNet Services has put forward a reasonably informed initial proposal. There are few areas of contention remaining between now and our final decision which is due

⁴ AEMO, *Electricity Transmission Use of System Prices 1 July 2021–30 June 2022*, 3 May 2021.

in January 2022. AusNet Services now has an opportunity, in its September 2021 revised proposal, to update its position and reconcile our few remaining concerns. It is important AusNet Services provides us with a complete revised proposal with all the information we need to inform our final decision. This will afford consumers and other stakeholders the opportunity to have their feedback considered prior to our final decision.

Capex

Our draft decision approves \$753.8 million (\$2021–22) of total capex for AusNet Services for the 2022–27 regulatory control period. This is \$44 million or 5.5 per cent less capex than proposed by AusNet Services.

The majority of AusNet Services' capex is for asset replacement, around 80 per cent of the total capex. This has been the focus of our capex review. AusNet Services has applied an economic risk-based approach to asset replacement that we consider is good industry practice and it has made incremental improvements in its economic risk methodologies in recent years. We endorsed this approach in our previous regulatory decisions⁵ and it is also supported by the CCP23 submission.⁶

On this basis we consider that AusNet Services' capex is broadly acceptable. However, our draft decision is \$44 million less than AusNet Services proposal because we identified three components of AusNet Services' capex forecast that are not required to meet its asset replacement needs, or do not reflect the efficient costs of doing so. These are:

- an upgrade to its networks communications systems
- an allowance for pricing and volume risk on its asset replacement program
- an estimated increase in the costs of its external contracted costs.

Our draft decision is based on the information available to us and AusNet Services at this time. As noted below, AusNet Services is considering new information that may potentially change its capex forecast. This will need to be fully addressed by AusNet Services in its revised proposal. Given this, our draft decision should be considered a placeholder decision as opposed to the likely final position, which will require further consideration following AusNet Services' revised proposal.

Opex

Our draft decision approves \$1318.6 million (\$2021–22) of total opex for the 2022–27 period. This is \$104.2 million or 7.3 per cent less opex than proposed by AusNet Services. The key area of difference in our opex draft decision relates to opex step changes. AusNet Services proposed seven step changes totalling \$108.7 million (\$2021–22) or 7.6 per cent of its proposed total opex forecast. Our draft decision for step changes is \$105.5 million (\$2021–22) lower than AusNet Services' proposal because at this stage we have not included costs for cyber security, council rate changes or amendments to the Environmental Protection Act.

⁵ AER, *Final decision, AusNet Services transmission determination 2017–22, Overview*, April 2017.

⁶ CCP23, *Advice to AER on AusNet Services Transmission regulatory proposal*, 12 February 2021.

AusNet Services proposed a cyber-security step change of \$27.9 million as part of its opex to enable it to proactively comply with and maintain the anticipated Maturity Indicator Level 3 standard under AEMO's Australian Energy Sector Cyber Security Framework. We consider it prudent for AusNet Services to achieve this level of maturity and agree that a step change is required to fund additional investment. However, at the time of making this draft decision we do not have enough information to inform our assessment of the efficient costs required for AusNet Services to achieve this outcome. We expect to receive further information from AusNet Services on its proposed cyber security costs to inform our final decision.

AusNet Services also proposed a \$71.5 million (\$2021–22) step change to reflect an increase in council rates due to a planned change in the valuation of terminal station assets. As the expected timing and impact of this change is uncertain we have not included this step change in our alternative estimate for the draft decision. We also expect to receive further information to substantiate AusNet Services' proposed council rate costs to inform our final decision.

AusNet Services proposed a step change of \$3.2 million (\$2021–22) to comply with its new obligations under the Environment Protection Amendment Act 2018 (2018 Amending Act).⁷ We consider it prudent for AusNet Services to comply with the new requirements of the 2018 Amending Act and agree that a step change may be required to fund these additional duties. However, we seek further information from AusNet Services to inform our assessment, particularly around the efficiency of these costs, for the final decision.

Depreciation

We determine a regulatory depreciation amount of \$560.2 million (\$nominal) for AusNet Services for the 2022–27 regulatory control period, which is \$15.1 million or 2.8 per cent higher than AusNet Services' proposed regulatory depreciation amount of \$545.1 million (\$nominal). This increase is due to our calculation of expected inflation resulting from our 2020 inflation review⁸ that more than offsets changes to accelerated depreciation and other components of AusNet Services' proposal that affect the forecast regulatory depreciation amount (such as the value of the asset base and the forecast capex amount).

To facilitate accelerated depreciation, AusNet Services proposed two new asset classes to separate insulators and instrument transformers from the broader asset classes they relate to. The CCP23 noted the lack of consumer involvement in AusNet Services' preparation of its accelerated depreciation proposal and therefore did not endorse this aspect of AusNet Services' proposal.⁹ It recommended that we closely investigate the proposal. It noted concerns with how the assets were valued and the standard asset lives proposed for the assets.

⁷ AusNet Services, *Electricity Transmission Revenue Reset - Appendix 5B Standalone EPA step change*, October 2020, p. 1.

⁸ AER, *Final position, Regulatory treatment of inflation*, December 2020.

⁹ CCP23, *Advice to the AER on AusNet Services electricity transmission revenue proposal*, 12 February 2021, pp. 33–35.

Having investigated this aspect of the proposal, we have partially accepted AusNet Services' proposal for accelerated depreciation of certain assets. However, we have determined not to accept the creation of the new instrument transformers asset class. We consider the current standard asset life for instrument transformers in the broader 'Switchgear' asset class will continue to be reflective of the economic life of these assets in the long run. We have also limited the new insulators asset class to those made of polymeric materials. We consider the current standard asset life for glass and porcelain insulators will continue to be reflective of the economic life of these assets in the long run, but accept that there is sufficient evidence to suggest polymeric insulators do have a shorter life.¹⁰

Potential changes between AusNet Services' initial and revised proposals

AusNet Services has advised us its revised proposal is likely to be different to its initial proposal. This is because:

- AusNet Services will use a new updated demand forecast, which may have an impact on its capex and opex forecasts
- AEMO has identified declining system strength in Victoria due to the impact of falling minimum demand and growing photovoltaic (PV) generation on system voltage. AusNet Services may need to acquire system strength support services to allow it to manage outages while it performs work on a number of its major station projects
- the Victorian Government has made recent announcements about renewable energy zones and requirements to connect to these zones or otherwise augment the transmission network.

If AusNet Services' revised proposal is significantly different to its initial proposal, AusNet Services will need to demonstrate that it has consulted with stakeholders, and has their support on any revised expenditure forecasts. AusNet Services held a series of workshops, over April to June 2021, to engage with stakeholders prior to the release of its revised proposal. AusNet Services' revised proposal will need to demonstrate how it has taken into account the views of stakeholders in framing its revised proposal.

The key themes of our draft decision are:

- ensuring consumers pay no more than they need for safe, secure and reliable services
- AusNet Services' engagement with customers
- the evolving operating environment in Victoria.

¹⁰ We have therefore required the new asset class for insulators be limited to 'polymeric insulators' with a standard asset life of 35 years.

Ensuring consumers pay no more than necessary for safe, secure and reliable services

Ensuring consumers pay no more than necessary for safe, secure and reliable electricity is a cornerstone of the regulatory determination process. Our role is to assess whether AusNet Services' proposal is a reasonable and realistic forecast of what is needed to provide a safe, secure and reliable operation of the network over the next regulatory control period (2022–27). This also involves encouraging AusNet Services to explore how they can provide better services at lower cost through a range of incentive schemes.

A feature of this review has been the need for safeguarding the security of electricity supply to consumers where the use of technology and the necessity for cyber security is becoming more prevalent. For the energy industry, a data breach could have serious consequences. A secure network protects a businesses data and the integrity of its assets and those connecting to its network. This is an important consideration for critical infrastructure such as electricity transmission networks that rely on sophisticated control and operation systems to ensure the continued supply of electricity.

We support prudent and efficient investment by businesses to make the networks we regulate secure. As discussed above, while we accept that it is prudent for AusNet Services to meet the higher cyber security capabilities required of a transmission provider, further information is required before we can substantiate the proposed step change cost is efficient. We will continue to engage with AusNet Services in the lead up to our final decision on this element of its proposal.

Overall, we require further information from AusNet Services before we are satisfied that the revenue we have determined AusNet Services can recover from its customers for the 2022–27 regulatory control period is in the long-term interests of consumers and that its customers are paying no more than they should for safe, secure and reliable electricity.

AusNet Services' engagement with customers

Consumer engagement helps businesses determine how best to provide services that align with consumers' long-term interests. Consumer engagement in this context is about AusNet Services working openly and collaboratively with consumers and providing opportunities for their views and preferences to be heard and to influence AusNet Services decisions.

In the regulatory process, stronger consumer engagement can help us test network service providers' expenditure proposals, and can raise alternative views on matters such as service priorities, capex and opex proposals, and tariff structures.

We determine if the revenue AusNet Services can recover from its customers for the 2022–27 regulatory control period is in the long-term interests of consumers. To do this, we used a range of considerations to demonstrate whether consumers had been genuinely engaged in the development of AusNet Services' 2022–27

regulatory proposal. The framework used for considering consumer engagement arose from our Victorian electricity decisions¹¹ and is replicated at appendix C. This framework includes the consideration of the nature, breadth and depth of the engagement, and clearly evidencing the impact that consumer engagement had on the proposal and assessment of proposed expenditure outcomes.

It is important to determine the appropriate level of consumer engagement required at each stage of the review process noting that not all network businesses are the same. Distribution businesses, for example, are one step closer to the final customer compared to transmission businesses. This means the decisions made by a distribution business will, all else equal, have a larger impact on consumer bills compared to a decision made by a transmission business. It is not uncommon to experience lower interest from consumers around a transmission review decision than a distribution decision. While we acknowledge the level of stakeholder engagement suitable for a transmission review is generally less intensive than that required for a distribution review, we observed AusNet Services' consumer engagement prior to and in the months following the release of its proposal was not as comprehensive and effective as we would have expected.

Despite this, AusNet Services' consumer engagement picked up momentum at the end of April 2021 when it began delivery of a series of stakeholder engagement workshops regarding the potential changes to its expenditure forecasts. These workshops allowed stakeholders to consider how new information might affect AusNet Services' revised proposal and gave stakeholders the opportunity to influence the changes that may need to be made to AusNet Services' revised proposal.

We look forward to consulting with stakeholders about this process and are particularly interested in whether stakeholders felt they were able to influence the outcome of AusNet Services' revised proposal. We encourage AusNet Services to continue to engage with its stakeholders during the lead up to its revised proposal. In particular, we ask AusNet Services to consider how topics are brought up for discussions with stakeholders. For example, advice from CCP23 suggested stakeholders were responsible for introducing issues for discussion in workshops. While we support this, we think it would be best complemented with an approach where AusNet Services raises issues they think would affect customers, for example, changes to the treatment of depreciation which affects customer prices.

Section 1.5 details further consideration of AusNet Services' consumer engagement program.

¹¹ See table 7; AER, *Draft decision, Jemena distribution determination 2021–26, Overview*, September 2020, p. 43.

An evolving operating environment in Victoria

The Victorian energy market is undergoing a number of changes that are expected to have an impact on the environment under which AusNet Services is operating in Victoria.

The Victorian Government has made recent announcements about renewable energy zones and requirements to connect to these zones or otherwise augment the transmission network. In addition, the closure of Yallourn power station has been brought forward to 2028. AusNet Services is currently considering whether these announcements will affect the need and timing of its major replacement projects and the interlinkages with augmentation projects.

AEMO has also identified declining system strength in Victoria due to the impact of falling minimum demand and growing PV on system voltage. AusNet Services is not proposing any capex projects to maintain system strength in its regulatory proposal (as this would be an augmentation project). However, AusNet Services may need to acquire system strength supply services to allow it to manage outages while it performs work on three of its major station projects. This would increase the overall cost of these major station projects and may defer the prudent timing of these projects.

Next steps

AusNet Services now has the opportunity to consider our draft decision. It must submit its revised proposal to us by **2 September 2021**.

Interested stakeholders are invited to attend an online predetermination conference hosted by the AER and AusNet Services to assist them in making submissions. This conference will be held on **5 August 2021**.

Interested stakeholders are invited to make submissions on both our draft decision and AusNet Services' revised proposal (once submitted) by **5 October 2021**.

We will make our final decision by **31 January 2022**.

1 Our draft decision

In this section we briefly outline what is driving AusNet Services' revenue, key differences between our draft decision revenue of \$2837.8 million (\$nominal, smoothed) compared to AusNet Services' proposed \$2882.6 million (\$nominal, smoothed) and the likely bill impacts on customers.

1.1 Victorian electricity transmission

In Victoria, two separate organisations are responsible for the electricity transmission network—AusNet Services and the Australian Energy Market Operator (AEMO). Under this model, the transmission network planning functions in Victoria are separated from network ownership and operation.

AusNet Services is the transmission network service provider (TNSP) which owns and operates Victoria's electricity transmission network. It is responsible for transporting electricity from generation sources into Victoria's five lower-voltage distribution networks.

AEMO is also a designated TNSP and is responsible for planning and procuring the augmentation of the Victorian shared transmission network. Given that AEMO is responsible for augmentation investment and plans, these costs are not included in AusNet Services' revenue proposal.

Under the NER, AEMO is required to submit its 2022–27 proposed pricing methodology to the AER for approval. This was submitted to us on 19 April 2021 and is open for consultation until 27 July 2021. We also published our Issues Paper for the AEMO pricing methodology on 15 June 2021.¹²

1.2 What is driving revenue?

Over time inflation impacts the spending power of money. To compare revenue from one period to the next on a like for like basis, we use 'real' values based on a common year (in this case, 2021–22), which have been adjusted for the impact of inflation.¹³

This draft decision approves a total revenue for the 2022–27 period that is \$80.6 million (2.9 per cent) lower than we approved in our 2017–22 final decision.¹⁴

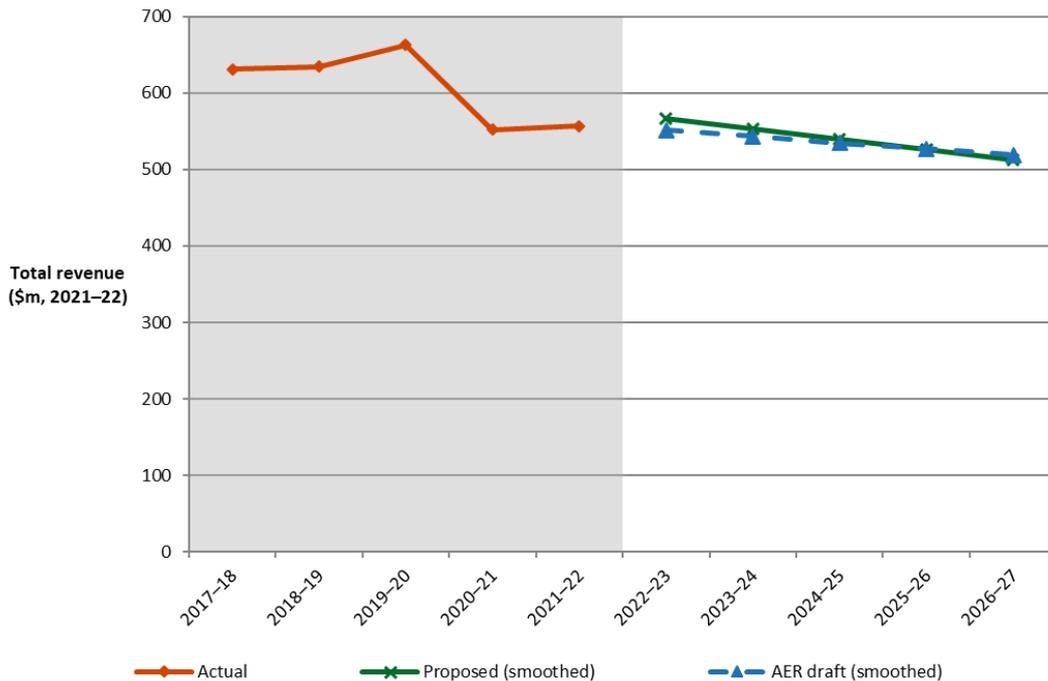
Figure 1 shows real revenues decreasing from the actual 2021–22 levels by 1.14 per cent in 2022–23, followed by decreases of 1.5 per cent per annum over the remaining years.

¹² See: <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/aemo-determination-2022-27>

¹³ That is, 30 June 2022 dollar terms based on AusNet Services' estimated actual revenue for 2021–22.

¹⁴ The comparison of total revenues between 2022–27 and 2017–22 periods is based on smoothed revenues. In nominal dollar terms, our draft decision total revenues for the 2022–27 period is \$104.5 million, or 3.8 per cent, higher than the total revenues approved for the 2017–22 period.

Figure 1 Changes in transmission revenue over time (\$million, 2021–22)



Source: AER Analysis.

Figure 2 highlights the key drivers of the decrease in AusNet Services’ allowed revenue from the 2017–22 period compared to what we expect in the 2022–27 period. It shows that our 2022–27 draft decision provides for reductions in the building blocks for:

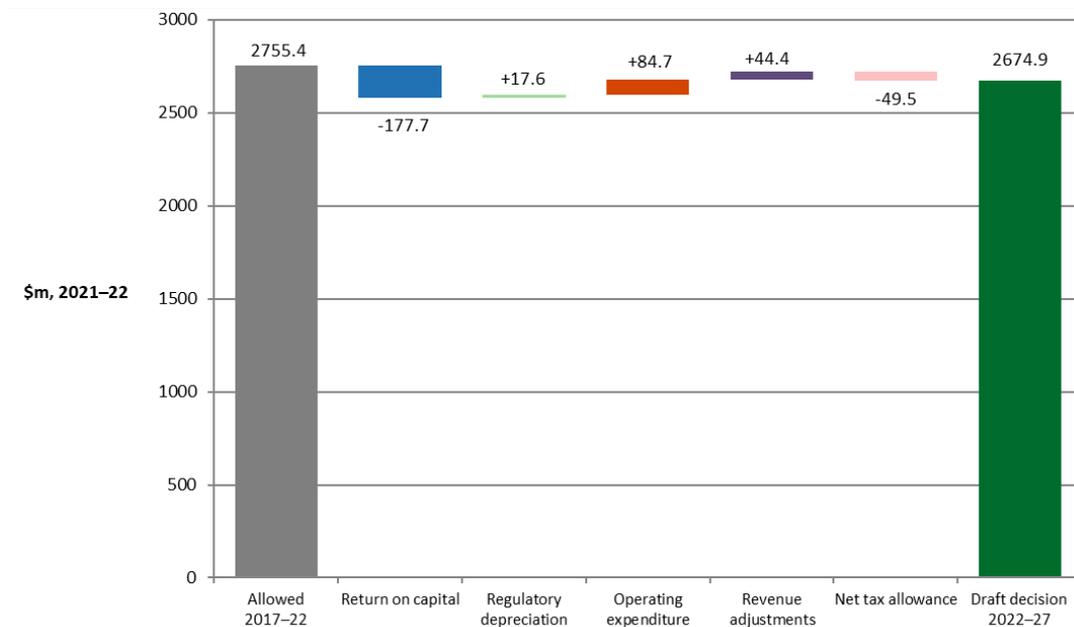
- return on capital, which includes capex and its financing cost (see Figure 6 below) which is \$177.7 million (18.5 per cent) lower than 2017–22 driven largely by a lower rate of return being applied in the 2022–27 regulatory control period
- net tax allowance, which is \$49.5 million (82.4 per cent) lower than 2017–22, predominately as a result of lower return on equity, higher gamma, and our new regulatory tax approach following the recent tax review.

Figure 2 also shows that our 2022–27 draft decision provides for an increase in the building blocks for:

- operating expenditure, which is \$84.7 million (or 6.9 per cent) higher than 2017–22, primarily driven by a higher forecast for easement land tax
- revenue adjustments, which are \$44.4 million higher than 2017–22, due to a positive efficiency benefit sharing scheme (EBSS) carryover, the first time application of a capital expenditure sharing scheme (CESS) adjustment resulting in a revenue increment to AusNet Services and the first time application of a demand management innovation allowance mechanism (DMIAM). In the 2017–22 regulatory control period AusNet Services did not have significant revenue adjustments and as a result this is a material increase above the 2017–22 regulatory control period (see section 2.6)

- regulatory depreciation, which is \$17.6 million (or 3.5 per cent) higher than 2017–22, driven by accelerated depreciation and a higher regulatory asset base (RAB) on average (See Figure 3).

Figure 2 Change in transmission revenue from 2017–22 to 2022–27 (\$million, 2021–22, unsmoothed)



Source: AER analysis.

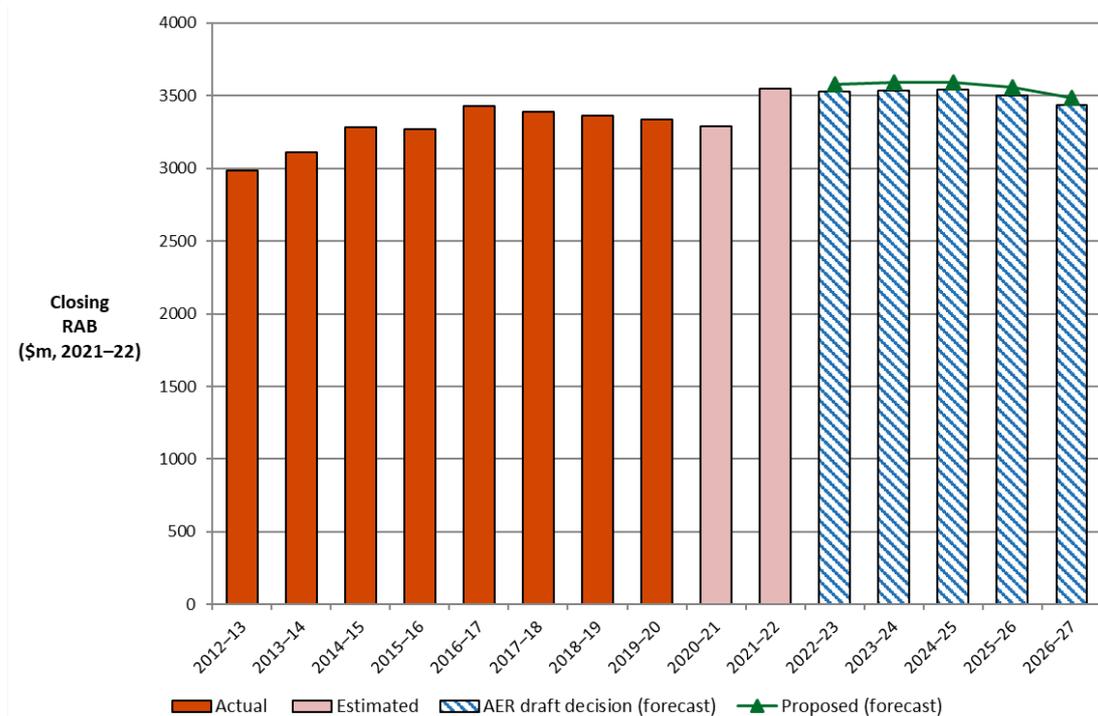
Figure 3 shows the value of AusNet Services’ RAB overtime. RAB growth is a key issue for many stakeholders because the value of the RAB substantially impacts AusNet Services’ revenue requirement, and the price consumers ultimately pay. Other things being equal, a higher RAB would increase both the return on capital and depreciation (return of capital) components of the revenue determination.

As can be seen from Figure 3, our draft decision results in a declining forecast RAB over the 2022–27 regulatory control period. The inclusion of ‘growth assets’ at the start of the 2022–27 regulatory control period explains the increase at that time.¹⁵ The forecast RAB does not include any growth assets (augmentation capex), which

¹⁵ \$296.3 million (\$nominal) of ‘growth assets’ have been rolled into the RAB for 2017–22 (see attachment 2, table 2.1 - AER’s draft decision on AusNet Services’ RAB for the 2017–22 regulatory control period). The growth assets are capital expenditure works done by AusNet Services during a regulatory control period as a result of requests from AEMO or distribution network service providers. While the assets constructed due to these requests provide prescribed transmission services, the forecast capex associated with these assets sit outside of the revenue determination. This is because AusNet Services is not responsible for the planning of these expenditures. These growth assets sit outside of the RAB and are governed by commercial contracts until such time as they are rolled into the RAB at the subsequent revenue determination. That is, the residual value of the capex amounts are rolled into the RAB at the start of the next regulatory control period. AusNet Services has proposed and the AER has accepted the inclusion of growth assets into the RAB in previous regulatory control periods, which at the time the assets were labelled as ‘group 3 assets’.

may be commissioned during the 2022–27 regulatory control period. These assets would be added to the RAB at the next regulatory review.

Figure 3 Value of AusNet Services' RAB over time - actual RAB, proposed forecast RAB and AER draft decision (\$million, 2021–22)



Source: AER, *AusNet Services revenue decision 2017–22 - Post tax revenue model*, April 2017; AER, *AusNet Services revenue decision 2017–22 - Roll forward model*, April 2017; AER, *AusNet Services revenue draft decision 2022–27 - Post Tax Revenue Model*, June 2021 and AER, *AusNet Services revenue draft decision 2022–27 - Roll Forward Model*, June 2021.

1.3 Key differences between our draft decision and AusNet Services' proposal

AusNet Services proposes total forecast revenue of \$2698.2 million for the 2022–27 period (\$2021–22).¹⁶ Our draft decision of \$2674.7 million allows \$23.5 million (0.9 per cent) less revenue than AusNet Services seeks to recover through its 2022–27 proposal (\$2021–22).¹⁷

The biggest contributor to the difference between our draft decision revenue and AusNet Services' proposal is operating expenditure. Our draft decision approves an operating expenditure of \$1318.6 million (\$2021–22) which is \$104.2 million (\$2021–22) (or 7.3 per cent) lower than that proposed by AusNet Services. This is

¹⁶ AusNet Services, *Revenue Proposal 2023–27, Post Tax Revenue Model - Revised*, 18 February 2021.

¹⁷ In nominal terms, AusNet Services proposes total forecast revenue of \$2882.6 million for the 2022–27 period (smoothed). Our draft decision of \$2837.8 million allows \$44.8 million (or 1.6 per cent) less revenue than AusNet Services seeks to recover through its 2022–2027 proposal (\$nominal).

driven by our decision not to accept a number of AusNet Services' proposed step changes. AusNet Services proposed seven step changes totalling \$108.7 million (\$2021–22). Our draft decision is to accept \$3.1 million (\$2021–22) in opex step changes which is \$105.5 million (\$2021–22) lower than AusNet Services' proposal. This is because we have not included costs for cyber security, council rates or amendments to the Environmental Protection Act. While we consider these step changes are necessary, we do not have enough information to inform our assessment of the efficient costs of these step changes.

The other contributing factor to the reduction in revenue is AusNet Services' total forecast capex. While we consider that AusNet Services has broadly proposed an amount of capex to meet its prudent asset replacement needs, it did include some capital investment that went beyond what is efficient and prudent for the maintenance and operation of its network.

The lower capex forecast we have substituted for the purposes of this draft decision will lower the value of AusNet Services' RAB over the 2022–27 regulatory control period. We have approved \$753.8 million in capex (\$2021–22), a reduction of \$44 million (\$2021–22) or 5.5 per cent compared to AusNet Services' proposed value of \$797.7 million (\$2021–22) (see Section 2.4).

The impact on revenue arising from the reductions in opex and capex is offset by increases in other components. Our decision provides for an increase in the building blocks for:

- return on capital, this is \$49.7 million (\$2021–22) (or 6.8 per cent) higher than that proposed by AusNet Services. This is driven by higher rates of return from equity and debt, principally due to an increase in interest rates
- regulatory depreciation, this is \$18.2 million (\$2021–22) (or 3.6 per cent) higher than that proposed by AusNet Services. This is driven by a reduction to the inflation indexation which increases regulatory depreciation (but is also partially offset by lower approved accelerated depreciation)
- net tax allowance, this is \$9.5 million (\$2021–22) (or 844.0 per cent) higher than that proposed by AusNet Services. This is driven by a higher return rate of return on equity which increases taxable income, and therefore resulted in a higher cost of corporate income tax
- revenue adjustments, these are \$2.5 million (\$2021–22) (or 7.4 per cent) higher than that proposed by AusNet Services. This is driven by increased payments from the incentive schemes (CESS and EBSS).

1.4 Expected impact of our draft decision on electricity bills

Transmission charges account for a relatively small percentage of a residential customers' annual electricity bill. The annual electricity bill for customers in Victoria will reflect the combined cost of all the electricity supply chain components—wholesale energy generation, transmission, distribution, metering, and retail costs.

In Victoria, this also includes the recovery of the Victorian Government's Easement Tax, which is recovered through AusNet Services' network tariffs.¹⁸

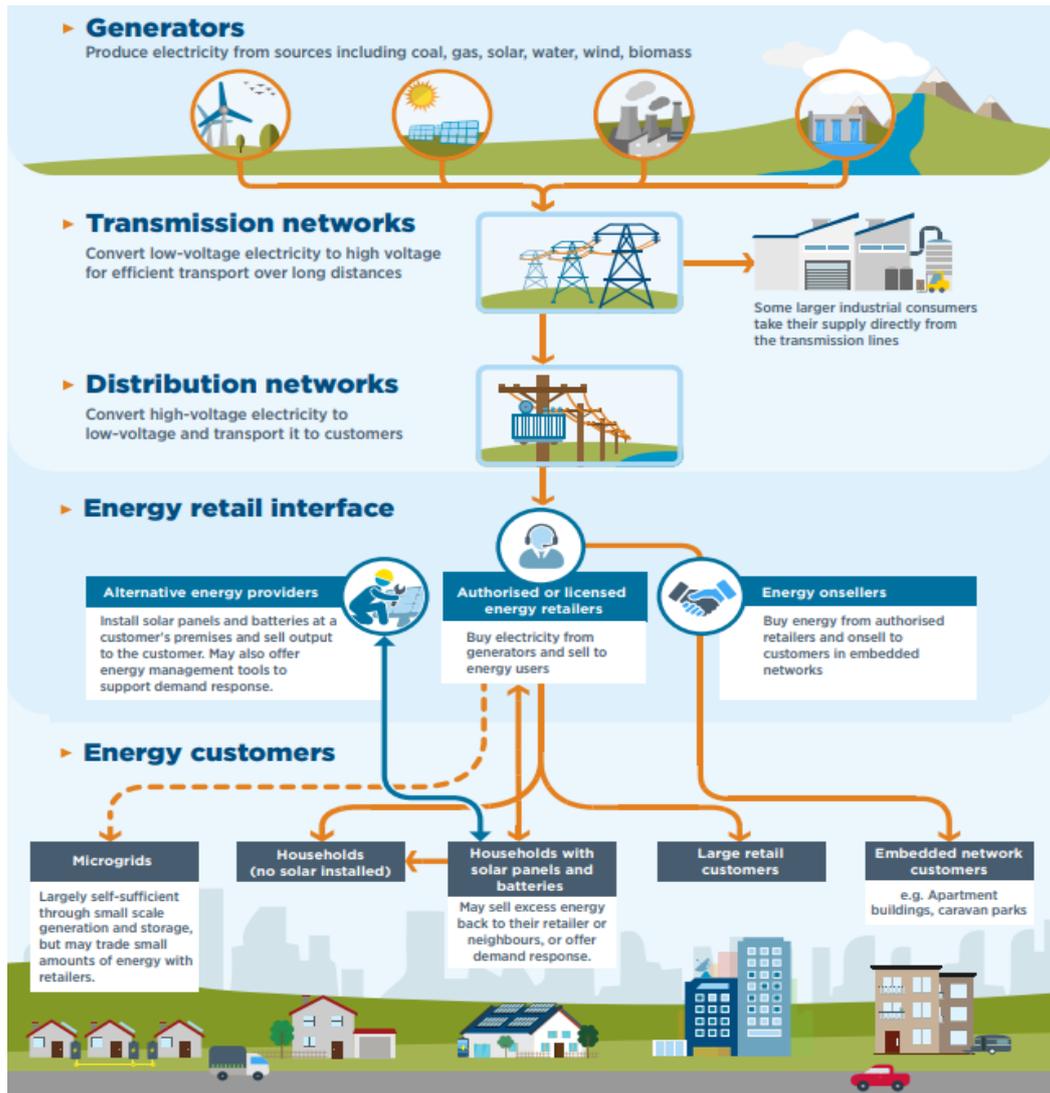
On average, transmission charges account for approximately 5.5 per cent of a Victorian residential customer's annual electricity bill. This small percentage largely explains the relatively modest average annual electricity bill impacts arising from our draft decision. We estimate the expected bill impact by varying the transmission charges in accordance with our draft decision, while holding other components of the bill constant. This approach isolates the effect of our decision on electricity prices, but does not imply that other components will remain unchanged across the regulatory control period.¹⁹

Figure 4 illustrates the different components of the electricity supply chain. Each of these costs contributes to the retail prices charged to consumers by their chosen electricity retailer.

¹⁸ AEMO, *Electricity Transmission Use of System Prices 1 July 2021–30 June 2022*, 3 May 2021.

¹⁹ It also assumes that actual energy demand will equal the forecast in our draft decision. Since AusNet Services operates under a revenue cap, changes in demand will also affect annual electricity bills across the 2022–27 regulatory control period.

Figure 4 Electricity supply chain



Source: AER, *State of the Energy Market*, July 2020, p. 25.

Transmission charges

Figure 5 below shows the indicative average transmission charges over the period 2017–18 to 2026–27 in real 2021–22 dollar terms. These amounts are an approximation of transmission charges (measured in MWh).²⁰ Based on this approach, we estimate that this draft decision will result in a small decrease in annual average transmission charges over the next regulatory control period.

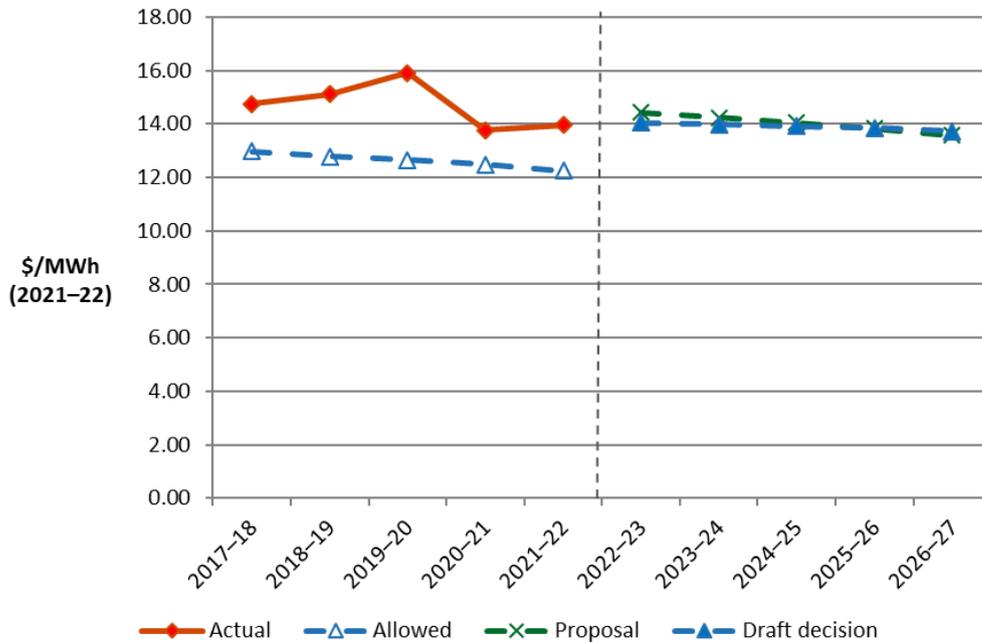
The average transmission charges for AusNet Services are expected to decrease slightly from around \$14.0/MWh for the 2017–22 regulatory control period²¹ to \$13.7/MWh for the 2022–27 regulatory period, in real 2021–22 terms.

²⁰ We estimate the forecast average transmission charge by taking AusNet Services expected revenue and dividing it by the forecast annual energy delivered in Victoria as published by AEMO.

²¹ Transmission charges for 2017–18 to 2019–20 are based on actual revenue, while 2020–21 and 2021–22 and transmission charges are based on estimated revenue.

However, we emphasize this is based on our placeholder draft decision and the average transmission charges are likely to be higher in our final decision due to further assessment of AusNet Services' opex step changes.

Figure 5 Indicative transmission price path for AusNet Services (\$/MWh, 2021–22)



Source: AER analysis. AEMO, *National Electricity and Gas forecasting - 2019 Electricity Statement of Opportunities, Electricity and consumption forecast for Victoria (operations out)*; AEMO, *National Electricity and Gas forecasting - 2020 Electricity Statement of Opportunities, Electricity and consumption forecast for Victoria (operations out)*. See <http://forecasting.aemo.com.au/Electricity/AnnualConsumption/Operational>, accessed on 19 May 2021.

Potential bill impact

We expect that the transmission component of the average annual residential electricity bill in 2026–27 will have increased by about \$6 (\$nominal) from the 2021–22 total bill level.

Similarly, for an average small business customer in Victoria, we expect the transmission component of the average annual small business electricity bill in 2026–27 will have increased by about \$24 (\$nominal) from the 2021–22 total bill level.

However, we emphasize this is based on our placeholder draft decision and these potential bills impacts are likely to be higher in our final decision due to further assessment of AusNet Services' opex step changes.

Table 1 shows the estimated impact of our draft decision on average residential and small business customers' annual electricity bills in Victoria over the 2022–27 regulatory control period, compared with AusNet Services' proposal. As explained above, these bill impact estimates are indicative only, and individual customers'

actual bills will depend on their usage patterns and the structure of their chosen retail tariff offering.

Table 1 Estimated contribution to annual electricity bills for the 2022–27 regulatory control period (\$nominal)

	2021	2022–23	2023–24	2024–25	2025–26	2026–27
AER draft decision						
Residential annual bill	1358	1360	1361	1362	1363	1364
Annual change		2 (0.1%)	1 (0.1%)	1 (0.1%)	1 (0.1%)	1 (0.1%)
Small business annual bill	5488	5495	5500	5504	5509	5512
Annual change		7 (0.1%)	5 (0.1%)	5 (0.1%)	5 (0.1%)	3 (0.1%)
AusNet Services proposal						
Residential annual bill	1358	1362	1363	1363	1364	1364
Annual change		4 (0.3%)	1 (0%)	1 (0%)	1 (0%)	0 (0%)
Small business annual bill	5488	5504	5507	5509	5512	5513
Annual change		16 (0.3%)	3 (0%)	3 (0%)	2 (0%)	1 (0%)

Source: Essential Services Commission of Victoria, *Victorian Default Offer 2021*, 20 November 2020, pp. 4–5, 47; AusNet Services, *Regulatory proposal 2023–27, Reset RIN Workbook 7*, 29 October 2020; AEMO, *National Electricity and Gas forecasting - 2019 Electricity Statement of Opportunities, Electricity and consumption forecast for Victoria (operations out)*, August 2019; AEMO, *National Electricity and Gas forecasting - 2020 Electricity Statement of Opportunities, Electricity and consumption forecast for Victoria (operations out)*, August 2020. See <http://forecasting.aemo.com.au/Electricity/AnnualConsumption/Operational>, accessed on 19 May 2021.

Note: Energy consumption figures used in the bill calculation are based on the average of AEMO's 2019 and 2020 *Electricity Statement of Opportunities* demand forecasts. We intend to use AEMO's 2021 forecasts for the final decision.

Further details regarding the calculation of AusNet Services' revenue and the impact on network charges are set out in attachment 1.

1.5 AusNet Services' consumer engagement

The National Electricity Objective focuses our work on the long-term interest of consumers²² and we think including consumers in the development of proposals is the best way to deliver this. Genuine, high quality engagement with consumers helps service providers better understand consumers' preferences and experiences and tailor their proposals to align with consumers' long-term interests. The NER also requires us to consider the extent to which elements of the proposal address relevant concerns identified during the transmission service providers' engagement with consumers.²³

We determine if the revenue AusNet Services can recover from its customers for the 2022–27 regulatory control period is in the long-term interests of consumers. To do this, we used a range of considerations to demonstrate whether consumers had been genuinely engaged in the development of AusNet Services' 2022–27 regulatory proposal. The framework used for considering consumer engagement arose from our Victorian electricity decisions²⁴ and is replicated at appendix C. This framework includes the consideration of the nature, breadth and depth of the engagement, and clearly evidencing the impact that consumer engagement had on the proposal and assessment of proposed expenditure outcomes.

AusNet Services established a transmission revenue reset Customer Advisory Panel. Panel membership was diverse, representing a wide range of AusNet Services' customers and other stakeholders including direct-connect customers, consumer advocacy groups, generators and the Victorian distribution businesses.²⁵

The CCP23 considered the panel an active, informed and engaged group. Although we recognise AusNet Services' consumer engagement plans in 2020 were disrupted by the on-set of the COVID-19 pandemic, the panel could have been engaged more consistently in the lead up to AusNet Services' revenue proposal. As CCP23 states in its advice to us:

The nature of engagement that we observed was appropriate for the work of AusNet Services Transmission.

The considerable gap in engagement between November 2019 and June 2020 is only partially explained by COVID-19. The [Customer Advisory Panel] is an active, informed and engaged group. While it has served AusNet Services well, it could have been engaged more usefully over the period.

*The high level of activity from late June through to September 2020 included three deep dive sessions and two briefings which we observed to be very effective.*²⁶

²² NEL, s. 16(1)(a).

²³ NER, cl 6A.6.6(e)(5A) and 6A.6.7(e)(5A).

²⁴ See table 7; AER, *Draft decision, Jemena distribution determination 2021–26, Overview*, September 2020, p. 43.

²⁵ Representatives include: Energy Consumers Australia; St Vincent de Paul; Ai Group; Energy Users Association of Australia; Blue Scope Steel; Alcoa; Air Liquide; United Energy; CitiPower / Powercor; Jemena; Hydro Tasmania.

²⁶ CCP23, *Advice to AER on AusNet Services Transmission regulatory proposal*, 12 February 2021, p. 20.

We note an obvious difference in the stakeholder engagement between AusNet Services' transmission business compared to its distribution business which trialled the 'NewReg' initiative.²⁷ We consider this to be a potential missed opportunity for AusNet Services transmission who could have leveraged off its distribution business' learnings when designing its consumer engagement program with its customers. As CCP23 identified in its advice to us:

*The AusNet Services distribution business appointed a Customer Forum through the "NewReg" trial. The Customer Forum negotiated directly with the business to reach agreements that were included in the regulatory proposal. This approach was not extended into developing the transmission business regulatory proposal.*²⁸

We are also concerned that, prior to its proposal, AusNet Services did not discuss its proposed changes to depreciation and asset classes with its Consumer Advisory Panel. While we are supportive of AusNet Services' approach to encourage panel members to raise issues for discussion and consideration, we consider it the responsibility of AusNet Services to initiate conversation where proposed changes put upward pressure on customer bills. This was highlighted by CCP23:

*CCP23 is concerned that AusNet Services does not appear to have discussed its proposal for changes to depreciation with the TRR Consumer Advisory Panel. Nor is this issue identified in the business' consumer engagement plans for 2021. CCP23 cannot therefore advise the AER that consumers have supported the proposed changes in approach.*²⁹

AusNet Services' consumer engagement picked up momentum at the end of April 2021 when it began delivery of a series of stakeholder engagement workshops. These workshops allowed stakeholders to consider how new information might affect AusNet Services' revised proposal and gave stakeholders the opportunity to influence the changes that could be made to AusNet Services' revised proposal.

AusNet Services planned to hold four consumer workshops over April to June 2021. In the first three workshops AusNet Services, with its panel, investigated network system strength; Renewable Energy Zone development; the Integrated System Plan (ISP) and the interactions with AusNet Services' replacement programs; and the impending closure of the Yallourn power station.

After commencing this stakeholder engagement program, AusNet Services added two workshops to its engagement program at the request of stakeholders. This included a second workshop on network system strength and a final workshop to be held in July, after the release of the draft decision. The July workshop is intended to summarise insights from the previous workshops and present initial responses to our draft decision and implications from stakeholder feedback.

²⁷ NewReg is a joint initiative between the AER, Energy Networks Australia and Energy Consumers Australia that explores ways to improve sector engagement and identify opportunities for regulatory innovation. The goal of this initiative is to ensure that customers' preferences drive energy network businesses' proposals and regulatory outcomes.

²⁸ CCP23, *Advice to AER on AusNet Services Transmission regulatory proposal*, 12 February 2021, p. 10.

²⁹ CCP23, *Advice to AER on AusNet Services Transmission regulatory proposal*, 12 February 2021, p. 35.

We are pleased by the intensity and consistency of AusNet Services' stakeholder engagement since April 2021. Engagement topics were relevant and discussions clearly valuable to the panel members.

Prior to topic selection, panel members had communicated to AusNet Services areas on which they desired a deeper level of understanding. This was the basis of workshop topic selection. Communication appropriately informed and educated the panel. At the conclusion of the workshop on network system strength the panel considered that a second network system strength workshop to further delve into emerging concerns, potential solutions and longer term thinking, would be of great value. The detail and depth to which AusNet Services explored issues with its panel is in line with our expectation of high quality stakeholder engagement.

AusNet Services clearly communicated the scope of each workshop to participants and were transparent about which parts of its proposal the panel were able to influence and what was uncontrollable by AusNet Services and therefore out of scope. Senior level staff were in attendance and actively participating in all workshops. AusNet Services were genuine, sincere and responsive to panel requests for information. The panel itself were keen to learn so they could make informed decisions about AusNet Services' revenue proposal. AusNet Services responded to this by providing various pre-reading material, where relevant prior to workshops.

It is important that AusNet Services provides us with a revised proposal that reflects consumer preferences expressed through the consultation process so that consumers and other stakeholders have the opportunity to provide formal feedback for our consideration prior to the release of our final decision.

We look forward to consulting with stakeholders about this process and are particularly interested in whether stakeholders felt they were able to influence the outcome of AusNet Services' revised proposal.

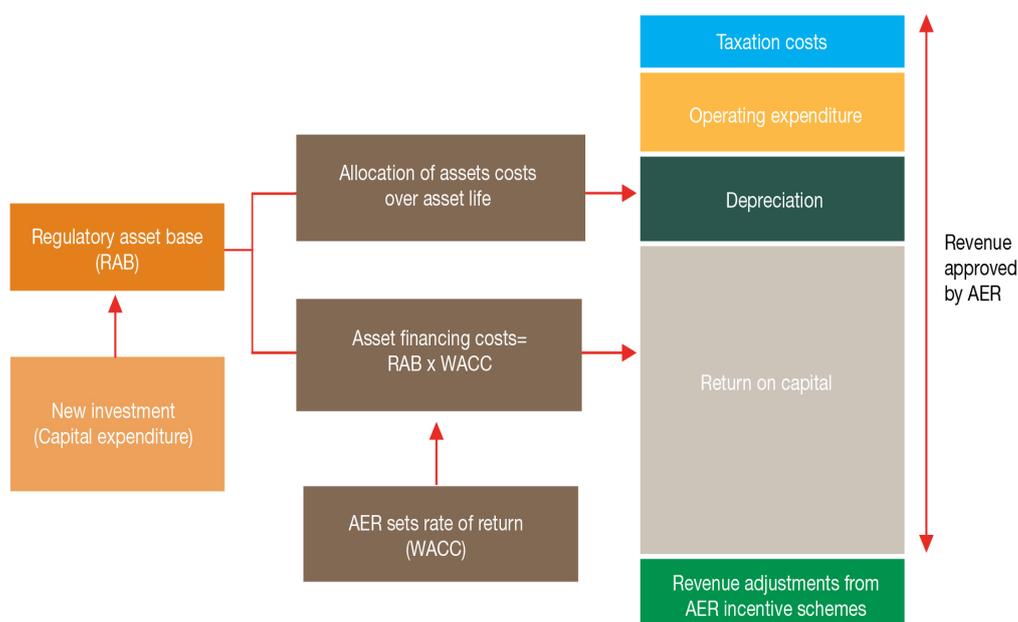
We encourage AusNet Services to continue with its recent high quality engagement program with its stakeholders during the lead up to its revised proposal.

2 Key components of our draft decision on revenue

The total revenue AusNet Services has proposed reflects its forecast of the efficient cost of providing its transmission network services over the 2022–27 regulatory control period. AusNet Services’ proposal, and our assessment of it under the NEL and NER, are based on a 'building block' approach to determine a total revenue allowance (see Figure 6) which looks at six cost components:

- a return on the RAB (or return on capital, to compensate investors for the opportunity cost of funds invested in this business) (section 2.2)
- depreciation of the RAB (or return of capital, to return the initial investment to investors over time) (section 2.3)
- capex—the capital costs and expenditure incurred in the provision of network services, which mostly relates to assets with long lives, the costs of which are recovered over several regulatory control periods. The forecast capex approved in our decisions directly affects the size of the RAB and therefore the revenue generated from the return on capital and depreciation building blocks (section 2.4)
- forecast opex – the operating, maintenance and other non-capital expenses, incurred in the provision of network services (section 2.5)
- revenue increments or decrements carried over from the previous regulatory control period, including the application of the incentive schemes, such as the EBSS and CESS (section 2.6)
- the estimated cost of corporate income tax (section 2.7).

Figure 6 The building block approach for determining total revenue



We use an incentive approach where, once regulated revenues are set for a five year period, networks who keep actual costs below the regulatory forecast of costs retain part of the benefit. This benchmark incentive framework is a foundation of the regulatory framework which aims to promote the NEO. Service providers have an incentive to become more efficient over time, as they retain part of the financial benefit from improved efficiency. Consumers also benefit when efficient costs are revealed and a lower cost benchmark is set in subsequent regulatory periods.

Our draft decision on AusNet Services' transmission revenues for the 2022–27 regulatory control period is set out in Table 2.

Table 2 AER's draft decision on AusNet Services' transmission annual building block revenue requirement, annual expected MAR, estimated total revenue cap and X factor (\$million, nominal)

	2022–23	2023–24	2024–25	2025–26	2026–27	Total
Return on capital	168.7	166.8	166.1	165.1	162.2	828.9
Regulatory depreciation ^a	114.3	97.9	107.2	116.9	124.0	560.2
Operating expenditure ^b	268.8	274.2	279.8	285.6	291.4	1399.8
Revenue adjustments ^c	18.4	8.6	7.0	5.2	–1.2	38.0
Net tax allowance	3.2	1.5	1.7	2.5	2.3	11.2
Annual building block revenue requirement (unsmoothed)	573.4	548.9	561.8	575.3	578.8	2838.1
Annual expected MAR (smoothed)	562.3	564.9	567.5	570.2	572.9	2837.8^d
X factor (%) ^e	n/a ^f	1.50%	1.50%	1.50%	1.50%	n/a

Source: AER analysis.

- (a) Regulatory depreciation is straight-line depreciation net of the inflation indexation on the opening RAB.
- (b) Includes debt raising costs.
- (c) Includes revenue adjustments from EBSS, CESS, DMIAM, and a shared assets adjustment.
- (d) The estimated total revenue cap is equal to the total annual expected MAR.
- (e) The X factors will be revised to reflect the annual return on debt update. Under the CPI–X framework, the X factor measures the real rate of change in annual expected revenue from one year to the next. A negative X factor represents a real increase in revenue. Conversely, a positive X factor represents a real decrease in revenue.
- (f) AusNet Services is not required to apply an X factor for 2022–23 because we set the 2022–23 MAR in this decision. The MAR for 2023–23 is around 1.14 per cent lower than the approved MAR for 2021–2022 in real terms, or 0.83 per cent higher in nominal terms.

In the sections below, we discuss each component of our decision on AusNet Services' revenue for 2022–27 in turn. Incentive schemes, including the EBSS, CESS, service target performance incentive scheme (STPIS) and demand management innovation allowance mechanism (DMIAM) are discussed in section 3.

2.1 Regulatory asset base

The RAB is the value of the assets used by AusNet Services to provide regulated transmission services. The size of the RAB—and therefore the revenue generated from the return on capital and return of capital building blocks—is directly affected by our assessment of capex. AusNet Services calculated its opening RAB as at 1 April 2022 and its closing RAB at 31 March 2027 in accordance with our roll forward model (RFM) and post-tax revenue model (PTRM).

Our draft decision is to determine an opening RAB value as at 1 April 2022 of \$3545.9 million (\$nominal). This value is \$35.9 million (or 1.0 per cent) lower than AusNet Services' proposed opening RAB of \$3581.9 million (\$nominal) as at 1 April 2022.³⁰ While we largely accept the proposed opening RAB, we made the following revisions:

- corrected a number of minor referencing errors in relation to the inputs for the final year asset adjustments
- updated the proposed value of the 'growth assets' to be rolled into the RAB based on additional information provided by AusNet Services
- updated inputs to the RFM as newer information has become available since AusNet Services submitted its proposal. These updates include:
 - actual CPI input for 2020–21
 - forecast inputs for the nominal weighted average cost of capital (WACC) and depreciation for 2020–21 and 2021–22 following the most recent return on debt update and approved cost past through in the 2017–22 PTRM.

Table 3 sets out our draft decision on the forecast RAB values for AusNet Services' over the 2022–27 regulatory control period.

³⁰ AusNet Services, *Revenue Proposal 2023–27*, 29 October 2020, p. 184. This RAB value is based on as-incurred capex.

Table 3 AER's draft decision on AusNet Services' RAB for the 2022–27 regulatory control period (\$million, nominal)

	2022–23	2023–24	2024–25	2025–26	2026–27
Opening RAB	3545.9	3597.2	3678.9	3756.7	3793.1
Capital expenditure ^a	165.6	179.5	185.0	153.2	122.0
Inflation indexation on opening RAB	70.9	71.9	73.6	75.1	75.8
Less: straight-line depreciation ^b	185.2	169.8	180.8	192.0	199.9
Closing RAB	3597.2	3678.9	3756.7	3793.1	3791.0

Source: AER analysis.

- (a) As-incurred, and net of forecast disposals. In accordance with the timing assumptions of the PTRM, the capex includes a half-year WACC allowance to compensate for the six-month period before capex is added to the RAB for revenue modelling.
- (b) Based on as-commissioned capex.

Further detail regarding the roll forward of AusNet Services' RAB is set out in attachment 2.

2.2 Rate of return and value of imputation credits

The return each business is to receive on its RAB (the 'return on capital') continues to be a key driver of proposed revenues. We calculate the regulated return on capital by applying a rate of return to the value of the RAB.

We estimate the rate of return by combining the returns of the two sources of funds for investment: equity and debt. The allowed rate of return provides the business with a return on capital to service the interest on its loans and give a return on equity to investors.

An accurate estimate of the rate of return is necessary to promote efficient prices in the long-term interests of consumers. If the rate of return is set too low, the network business may not be able to attract sufficient funds to be able to make the required investments in the network and reliability may decline. Conversely, if the rate of return is set too high, the network business may seek to spend too much and consumers will pay inefficiently high tariffs.

As required under the NEL, we have applied the 2018 Rate of Return Instrument (2018 Instrument)³¹ and estimate a placeholder allowed rate of return of 4.76 per cent (nominal vanilla) for this decision which will be updated for our final decision on the averaging periods.³² AusNet Services' initial proposal has adopted

³¹ AER, *Rate of return instrument*, December 2018. See <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/rate-of-return-guideline-2018/final-decision>

³² The legislative amendments to replace the (previous) non-binding Rate of Return Guidelines with a binding legislative instrument were passed by the South Australian Parliament in December 2018. See, Statutes Amendment (National Energy Laws) (Binding Rate of Return Instrument) Act 2018 (SA). NGL, Chapter 2, Part 1, division 1A; NEL, Part 3, division 1B.

the 2018 Instrument.³³ Our estimated placeholder rate of return is higher than AusNet Services proposed 4.44 per cent (nominal vanilla) rate of return, principally due to an increase in interest rates.

Our calculated rate of return, in Table 4 will apply to the first year of the 2022–27 regulatory control period. A different rate of return will apply for the remaining regulatory years of the period. This is because we will update the return on debt component of the rate of return each year in accordance with the 2018 Instrument to use a 10-year trailing average portfolio return on debt that is rolled-forward each year. Our draft decision is to accept AusNet Services' proposed risk free rate³⁴ and debt averaging periods because they satisfied the 2018 Instrument.³⁵

Further detail on our draft decision in regarding AusNet Services' allowed rate of return is set out in attachment 3.

Table 4 Draft decision on AusNet Services' rate of return (nominal)

	Previous Regulatory Period (2017–22)	AusNet Services' Initial Proposal (2022–27)	AER draft decision (2022–27)	Allowed return over regulatory control period
Nominal risk free rate	2.52%	0.93%	1.68% ^a	
Market risk premium	6.5%	6.1%	6.1%	
Equity beta	0.7	0.6	0.6	
Return on equity (nominal post-tax)	7.07%	4.59%	5.34%	Constant (%)
Return on debt (nominal pre-tax)	4.94% ^b	4.35%	4.36% ^a	Updated annually
Gearing	60%	60%	60%	Constant (60%)
Nominal vanilla WACC	5.79% ^b	4.44%	4.76%	Updated annually for return on debt
Expected inflation	2.40%	2.25%	2.00%	Constant (%)

Source: AER analysis.

(a) Calculated using a placeholder averaging period of 20 business days ending April.

(b) Applies to the first year of the 2017–22 regulatory control period.

³³ AusNet Services, *Revenue Proposal 2023–27*, 29 October 2020, p. 213.

³⁴ This is also known as the return on equity averaging period.

³⁵ AER, *Rate of return instrument*, December 2018, clauses 7–8, 23–25, 36; AER, *Draft decision, AusNet Services transmission determination 2022 to 2027, Attachment 3—Rate of return confidential appendix A: Equity and debt averaging periods*, June 2021.

Debt and equity raising costs

In addition to providing for the required rate of return on debt and equity, we provide an allowance for the transaction costs associated with raising debt and equity. We include debt raising costs in the opex forecast because these are regular and ongoing costs. We include equity raising costs in the capex forecast because these costs are only incurred once and would be associated with funding the particular capital investments.

We note AusNet Services has proposed to use our approach to estimate equity raising costs.³⁶ We have updated our estimate for this regulatory control period based on the benchmark approach using updated inputs. This results in zero equity raising costs.

Our draft decision is to accept the method used in AusNet Services' initial proposal to estimate debt raising costs, which uses an annual rate of 8.1 basis points per annum.³⁷ We have considered this annual rate and found our alternative benchmark estimate (8 basis points) is similar to AusNet Services' proposal.

Attachment 3 contains our draft decision reasoning on the benchmark calculation of debt raising costs.

Imputation credits

Our draft decision applies a gamma of 0.585 as per the binding 2018 Instrument.³⁸ AusNet Services' proposal has adopted the 2018 Instrument for gamma.³⁹

Expected inflation

Our estimate of expected inflation is 2.00 per cent which will be updated for the final decision. It is an estimate of the average annual rate of inflation expected over a five-year period based on the outcome of our 2020 Inflation Review.⁴⁰

We previously used December-ending Reserve Bank of Australia (RBA) consumer price index (CPI) forecasts to estimate forecast inflation in AusNet Services' 2017–22 revenue determination. This provided one year of forecast in the 2017–22 draft decision and two years of forecast in the 2017–22 final decision.

For this draft decision, we have continued this approach and used the RBA's CPI forecast for the year-ending December 2022 as the expected inflation estimate for year one of the regulatory period in this draft decision. We commenced the glide path in year two of the regulatory period consistent with the requirements of the

³⁶ AusNet Services, *Revenue Proposal 2023–27*, 29 October 2020, p. 216.

³⁷ AusNet Services, *Revenue Proposal 2023–27*, 29 October 2020, p. 216; AusNet Services, *Revenue Proposal 2023–27, Post Tax Revenue Model – Revised*, 18 February 2020.

³⁸ AER, *Rate of return instrument*, December 2018, clause 27.

³⁹ AusNet Services, *Revenue Proposal 2023–27*, 29 October 2020, p. 216.

⁴⁰ AER, *Final position, Regulatory treatment of inflation*, December 2020.

PTRM.⁴¹ For the final decision we will use the RBA forecast as set out in its November 2021 Statement of Monetary Policy which should have a CPI forecast for an additional year (year-ending December 2023). Therefore, in the final decision we will commence the glide path from year three to the mid-point of the RBA's inflation target band (2.5 per cent) in year five.

2.3 Regulatory depreciation (return of capital)

In our draft decision, we include an amount for the depreciation of AusNet Services' RAB (otherwise referred to as return of capital). Regulated service providers invest in large sunk assets to provide electricity services to customers. While some of the cost of such assets may be recovered from customers upfront, a greater proportion is recovered over time. The regulatory depreciation building block is used for this purpose.

In deciding whether to approve the regulatory depreciation proposed by AusNet Services, we make determinations on the indexation of the RAB and depreciation building blocks for AusNet Services' 2022–27 regulatory control period.⁴²

Our draft decision approves a regulatory depreciation amount of \$560.2 million (\$nominal) for the 2022–27 regulatory control period. This is \$15.1 million (2.8 per cent) higher than AusNet Services' proposed amount of \$545.1 million (\$nominal).

The change in expected inflation (section 2.2) and its impact on the indexation of the RAB, more than offsets our changes to accelerated depreciation and other components of AusNet Services' proposal that affect the forecast regulatory depreciation amount. Specifically:

- the opening RAB as at 1 July 2022 (section 2.1), and
- forecast capital expenditure (section 2.4) including its effect on the projected RAB over the 2022–27 regulatory control period.⁴³

For our draft decision on AusNet Services' regulatory depreciation we accept its proposed:

- straight-line depreciation method used to calculate the regulatory depreciation amount
- continuation of tracking the depreciation of its capex on a year-by-year basis
- asset classes and standard asset lives, with the exception of the proposed asset lives for new asset classes for existing and future insulators and instrument transformers. These exceptions have reduced the amount of accelerated depreciation compared to that sought by AusNet Services by about \$9 million for the 2022–27 regulatory control period.

⁴¹ AER, *Explanatory statement, Proposed amendments electricity transmission and distribution network service providers post-tax revenue models (version 5)*, December 2020, p. 11.

⁴² NER, cl. 6A.5.4 and 6A.14.1.

⁴³ Capex enters the RAB net of forecast disposals. It includes equity raising costs (where relevant) and the half-year WACC to account for the timing assumptions in the PTRM. Our draft decision on the RAB (attachment 2) also reflects our updates to the WACC for the 2022–27 regulatory control period.

Table 5 shows our draft decision on AusNet Services' regulatory depreciation for the 2022–27 regulatory control period.

Table 5 AER's draft decision on AusNet Services' regulatory depreciation for the 2022–27 regulatory control period (\$million, nominal)

	2022–23	2023–24	2024–25	2025–26	2026–27	Total
Straight-line depreciation	185.2	169.8	180.8	192.0	199.9	927.6
Less: inflation indexation on opening RAB	70.9	71.9	73.6	75.1	75.8	367.3
Regulatory depreciation	114.3	97.9	107.2	116.9	124.0	560.2

Source: AER analysis.

Further detail on our draft decision regarding depreciation is set out in attachment 4.

2.4 Capital expenditure

Capital expenditure (capex) refers to the investment in assets to provide services. This investment mostly relates to assets with long lives and these costs are recovered over several regulatory periods. On an annual basis, however, the financing cost and depreciation associated with these assets are recovered (return on and of capital) as part of the building blocks that form part of AusNet Services' total revenue requirement.

Our draft decision on AusNet Services' revenue includes \$753.8 million (\$2021–22) in forecast capex for the 2022–27 regulatory control period. This is \$44 million (or 5.5 per cent) lower than AusNet Services' proposed capex of \$797.7 million. Table 6 shows our decision compared to AusNet Services' forecast.

Table 6 AER draft decision on total forecast capex (\$million, 2021–22)

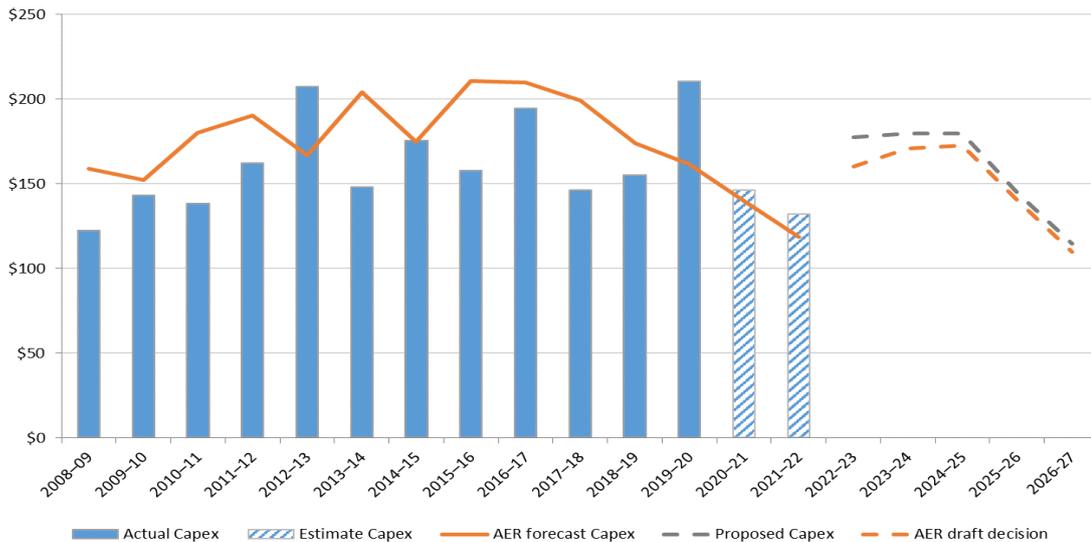
	2022–23	2023–24	2024–25	2025–26	2026–27	Total
AusNet Services' proposal	177.43	181.06	179.54	144.86	114.85	797.74
AER draft decision	160.47	170.75	172.72	140.25	109.60	753.78
Difference	-16.96	-10.31	-6.82	-4.61	-5.25	-43.96
Percentage difference (%)	-9.6%	-5.7%	-3.8%	-3.2%	-4.6%	-5.5%

Source: AER analysis.

Note: Numbers may not total due to rounding.

Figure 7 shows our transmission capex final decision compared to AusNet Services' proposal, its past allowances and past actual expenditure.

Figure 7 AER draft decision on capex (\$million, 2021–22)



Source: AER analysis.

The majority of AusNet Services’ capex is for asset replacement, which comprises approximately 80 per cent of the total proposed capex. AusNet Services does not propose any augmentation or connections capex, as AEMO is responsible for augmentation investment and planning in Victoria.

We reviewed AusNet Services capex proposal by reviewing each of its major capex categories, focusing our review on the forecasting methodology for asset replacement decisions, trend analysis, and a technical review of the prudence of specific projects and their efficient costs. We also considered AusNet Services’ top-down program reviews and consideration of deliverability issues.

We found that AusNet Services has applied a prudent economic risk-based approach to asset replacement that we consider is good industry practice and it has made incremental improvements in its economic risk methodologies in recent years. We endorsed this approach in our previous regulatory decisions⁴⁴ and it is also supported by the recent CCP23 submission.⁴⁵

AusNet Services has also conducted an effective top-down and deliverability review. As a result it has chosen to defer capex for certain major projects, removed duplication between asset replacement programs and optimised its civil works program. This lends further support to AusNet Services overall replacement capex.

On this basis we consider that AusNet Services’ capex is broadly acceptable. However, there are some components of AusNet Services’ capex forecast that are not required to meet its asset replacement needs, or do not reflect the efficient costs of doing so. These are:

- \$24 million upgrade to its networks communications systems, which is not supported by the good condition of its existing systems

⁴⁴ AER, *Final decision, AusNet Services transmission determination 2017–22, Overview*, April 2017.

⁴⁵ CCP23, *Advice to AER on AusNet Services Transmission regulatory proposal*, 12 February 2021.

- \$15 million risk allowance to account for pricing and volume risk on its asset replacement program, which AusNet Services is capable of prudently mitigating
- \$6.8 million to account for estimated increases in the costs of its external contracted costs, which is not supported by evidence and likely can otherwise be mitigated.

Our draft decision is based on the information available to us and AusNet Services at this time. AusNet Services has identified potential updates to its capex forecast based on new information, including updated project cost estimates, demand forecasts and interactions with other major projects and system requirements in Victoria. The outcome of these considerations will be addressed by AusNet Services in its revised proposal and given this, our draft decision should be considered a placeholder decision as opposed to the likely final position, which will require further consideration following AusNet Services' revised proposal.

The full detail on our draft decision regarding capex is set out in attachment 5.

2.5 Operating expenditure

Operating expenditure (opex) refers to the operating, maintenance and other non-capital expenses incurred in the provision of network and related services. Forecast opex for prescribed transmission services is one of the building blocks we use to determine a service provider's annual total revenue requirement.

We do not accept AusNet Services' updated transmission opex forecast of \$1422.8 million (\$2021–22)⁴⁶ for the 2022–27 regulatory control period because we are not satisfied that it reflects the opex criteria.⁴⁷ AusNet Services originally proposed an opex forecast of \$1370.7 million (\$2021–22)⁴⁸ and subsequently updated its opex forecast after it received its 2020–21 Land Tax Assessment Notice.⁴⁹

Our alternative estimate of total opex is \$1318.6 million (\$2021–22). This is \$104.2 million, or 7.3 per cent, lower than AusNet Services' forecast and largely reflects that we do not consider we currently have sufficient evidence to establish the efficient costs of several step changes. We are satisfied our alternative estimate of forecast opex reasonably reflects the opex criteria. Table 7 sets out AusNet Services' proposal, its updated proposal, our alternative estimate that is the basis for the draft decision and the difference between our draft decision and the updated proposal.

⁴⁶ AusNet Services, *Revenue Proposal 2023–27, Operating Expenditure Model - Revised*, 18 February 2021.

⁴⁷ NER, cl. 6A.6.6(c)-(d).

⁴⁸ AusNet Services, *Revenue Proposal 2023–27*, 29 October 2020, p. 133.

⁴⁹ AusNet Services, *2021 Land Tax Assessment Notice*, February 2021; AusNet Services, *Revenue Proposal 2023–27, Operating Expenditure Model - Revised*, 18 February 2021.

Table 7 Comparison of AusNet Services' proposals and our draft decision on opex (\$million, 2021–22)

Opex category	AusNet Services' proposal	AusNet Services' updated proposal	AER draft decision	Difference (\$)
Base (reported opex in 2020–21)	407.5	407.5	408.4	0.9
Base year adjustments	0.1	0.1	0.1	0.0
Final year increment	2.5	2.5	2.5	0.0
Trend: Output growth	–	–	–	–
Trend: Real price growth	5.0	5.0	5.5	0.5
Trend: Productivity growth	–3.8	–3.8	–3.8	–0.0
Step changes	108.7	108.7	3.1	–105.5
Category specific forecasts	842.0	894.2	894.2	–
Total opex (excluding debt raising costs)	1362.0	1414.1	1310.1	–104.0
Debt raising costs	8.7	8.7	8.5	–0.2
Total opex (including debt raising costs)	1370.7	1422.8	1318.6	–104.2
Percentage difference to proposal				–7.3%

Source: AusNet Services, *Revenue Proposal 2023–27, Operating Expenditure Model*, 29 October 2020; AusNet Services, *Revenue Proposal 2023–27, Operating Expenditure Model - Revised*, 18 February 2021; AER analysis.

Note: Numbers may not add up to total due to rounding. Differences of '0.0' and '–0.0' represent small variances and '–' represents no variance.

Figure 8 compares AusNet Services' updated opex forecast to its past actual opex, our previous regulatory decisions and our alternative estimate that is the basis for our draft decision.

Figure 8 Historical and forecast opex (\$million, 2021–22)



Source: AusNet Services, *Revenue Proposal 2023–27, Operating Expenditure Model - Revised*, 18 February 2021; AER, *Draft Decision, AusNet Services transmission determination 2022–27, Opex model*, June 2021; AER, *Draft Decision, AusNet Services transmission determination 2022–27, EBSS model*, June 2021; AER analysis.

Note: Includes debt raising costs.

Our lower alternative estimate of total opex is driven by the opex related to step changes being \$105.5 million (\$2021–22) lower than AusNet Services’ proposed. We have not included opex for the cyber security, Environmental Protection Act Amendment Act or the council rates step changes as we do not consider we have sufficient information to determine their efficient costs. We encourage AusNet Services to provide further information and evidence relating to these costs in its revised proposal. We have also included a lower forecast for the proposed five minute settlement step change to reflect the incremental costs above base opex. Offsetting this is our:

- base year opex, which is \$0.9 million (\$2021–22) higher as we have updated for the latest actual and inflation forecasts
- real price growth estimate, which is \$0.5 million (\$2021–22) higher as we have corrected and updated some of the inputs.

Further detail on our draft decision regarding opex is set out in attachment 6.

2.6 Revenue adjustments

Our draft decision on AusNet Services' total revenue includes a number of adjustments which are set out below. A majority of the revenue adjustments are due to the application of various incentive schemes which are outlined in section 3.

- **EBSS** – AusNet Services has accrued a positive EBSS carryover amount in the 2017–22 regulatory control period. Our draft decision includes a positive EBSS carryover totalling \$39.5 million (\$2021–22). This is \$1.4 million (\$2021–22) more than the \$38.1 million (\$2021–22) proposed by AusNet Services because we have made adjustments to the treatment of self insurance costs, adjusted historical inputs and updated actual and forecast inflation. The EBSS is intended to provide a continuous incentive for AusNet Services to pursue efficiency improvements in opex, and provide for a fair sharing of these between the business and its users. Consumers benefit from improved efficiencies through lower regulated prices. Further detail on our draft decision regarding the EBSS is set out in attachment 8
- **CESS** – AusNet Services has accrued a revenue increment under the CESS, which we applied in the current 2017–22 regulatory control period to incentivise AusNet Services to undertake efficient capex throughout the period. The CESS rewards efficiency gains and penalises efficiency losses, each measured by reference to the difference between forecast and actual capex. In the 2017–22 period, AusNet Services underspent against our capex forecast, and our draft decision is to approve a CESS revenue increment amount of \$5.1 million (\$2021–22). Further detail on our draft decision regarding the CESS is set out in attachment 9
- **DMIAM** – an amount of \$2.9 million (\$2021–22) has been applied to AusNet Services over the 2022–27 regulatory control period. The DMIAM aims to encourage transmission businesses to find investments that are lower cost alternatives to investing in network solutions. Further detail on our draft decision regarding the DMIAM is set out in attachment 11
- **Shared assets** – an amount of \$10.8 million (\$2021–22) has been applied as a revenue decrement to AusNet Services over the 2022–27 regulatory control period. We did not accept AusNet Services' proposed offset (reducing the decrement) of \$0.5 million as this amount did not relate to shared assets. Shared assets are used to provide both the prescribed services we regulate and unregulated services. If the revenue from shared assets is material, 10 per cent of the unregulated revenues that a service provider earns from shared assets will be used to reduce its revenue for prescribed services. Further detail on our draft decision regarding shared assets is set out in attachment 1.

2.7 Corporate income tax

Our draft decision includes the estimated cost of corporate income tax for AusNet Services' 2022–27 regulatory control period as part of our revenue determination.⁵⁰ It enables AusNet Services to recover the costs associated with the estimated corporate income tax payable during the regulatory control period.

We determined an estimated cost of corporate income tax of \$11.2 million (\$nominal) for AusNet Services over the 2022–27 regulatory control period. This is \$10.1 million higher than AusNet Services' proposed value of \$1.1 million.⁵¹

The key reasons for the increase are:

- an increase to the rate of return on equity (section 2.2)⁵²
- a reduction to the forecast immediately expensed capex⁵³
- a reduction to the proposed opening tax asset base (TAB) as at 1 April 2022⁵⁴
- reallocation of some forecast capex which meets the requirements of sections 43.15, 43.140 and 43.210 of the *Income Tax Assessment Act 1997* from the existing 'Premises' asset class into a new asset class labelled 'Buildings - capital works', which depreciates using the straight-line method rather than the diminishing value method.⁵⁵

We accept AusNet Services' proposed method to establish the opening TAB as at 1 April 2022. Based on the proposed approach and applying similar adjustments we made to the opening RAB (section 2.1), we have determined AusNet Services' opening TAB value as at 1 April 2022 of \$2842.8 million (\$nominal). This represents a decrease of \$0.9 million (or less than 0.1 per cent) compared to AusNet Services' proposal.

We accept AusNet Services' proposed weighted average method to calculate the remaining tax asset lives as at 1 April 2022 for its existing asset classes. The proposed method is a continuation of the approved approach used in the 2017–22 regulatory control period and applies the approach as set out in our RFM.

Further, we accept the remaining tax asset lives for most of the new asset classes proposed by AusNet Services related to capitalised leases, and insulators and

⁵⁰ NER, cl. 6A.6.4.

⁵¹ AusNet Services, *Revenue Proposal 2023–27, Post Tax Revenue Model – Revised*, 18 February 2021.

⁵² All else being equal, a higher rate of return on equity will increase the cost of corporate income tax because it increases the return on equity, a component of the taxable income.

⁵³ All else being equal, a lower immediately expensed capex amount will increase the cost of corporate income tax because it reduces the tax expense.

⁵⁴ All else being equal, a lower opening TAB value will reduce the tax depreciation, a component of the tax expense, and increase the cost of corporate income tax.

⁵⁵ All else being equal, the reallocation of capex from an asset class subject to diminishing value tax depreciation to straight-line tax depreciation reduces the tax depreciation in the short term (first 5 years of the asset's life). This increases the taxable income and therefore the cost of corporate income tax. In this case, the forecast capex to be allocated is around \$4 million over 5 years. Therefore, the impact of the reallocation is a relatively small amount of around \$0.1 million.

instrumental transformers that are to be decommissioned. However, we do not accept the proposed remaining tax asset lives for other existing insulators and instrument transformers. This is because we do not accept the creation of the proposed instrument transformer asset class and have limited the proposed insulator asset class to polymeric insulators.

Our adjustments to the return on capital (sections 2.1, 2.2 and 2.4) and the regulatory depreciation (section 2.3) building blocks affect revenues, which in turn impacts the tax calculation. The changes affecting revenues are discussed in attachment 1.

Table 8 shows our draft decision on AusNet Services' cost of corporate income tax for the 2022–27 regulatory control period.

Table 8 AER's draft decision on AusNet Services' cost of corporate income tax for the 2022–27 regulatory control period (\$million, nominal)

	2022–23	2023–24	2024–25	2025–26	2026–27	Total
Tax payable	7.8	3.6	4.0	6.1	5.5	27.0
Less: value of imputation credits	4.6	2.1	2.3	3.6	3.2	15.8
Net cost of corporate income tax	3.2	1.5	1.7	2.5	2.3	11.2

Source: AER analysis.

Further detail on our draft decision regarding corporate income tax is set out in attachment 7.

3 Incentive schemes to apply for 2022–27

Incentive schemes are a component of incentive based regulation and complement our approach to assessing efficient costs. These schemes provide important balancing incentives under the revenue determination we've discussed in section 2, to encourage AusNet Services to pursue expenditure efficiencies, while maintaining the reliability and overall performance of its network.

The incentive schemes that might apply to an electricity network as part of our decision are:

- the opex efficiency benefit sharing scheme (EBSS)
- the capital expenditure sharing scheme (CESS)
- the service target performance incentive scheme (STPIS)
- the demand management innovation allowance mechanism (DMIAM).

Once we make our decision on AusNet Services' revenue cap, it has an incentive to provide services at the lowest possible cost, because its returns are determined by its actual costs of providing services. Our incentive schemes encourage network businesses to make efficient decisions. They give network businesses an incentive to pursue efficiency improvements in opex and capex, and to share them with consumers. If networks reduce their costs to below our forecast of efficient costs, the savings are shared with their customers in future regulatory periods through the EBSS and CESS.

The STPIS is intended to balance a business' incentive to reduce expenditure with the need to maintain or improve service quality. It achieves this by providing financial incentives to businesses to maintain and improve service performance where customers are willing to pay for these improvements. Businesses can only retain their rewards for sustained and continuous improvements to the reliability of supply for customers. Once improvements are made, the benchmark performance targets will be tightened in future years. The STPIS for AusNet Services consists of a service component, network capability component and market impact component.

The DMIAM provides transmission businesses with funding for research and development in demand management projects that have the potential to reduce long-term network costs. Transmission businesses are required to share learnings and insights gained from implementing demand management projects across industry and consumers.

Our draft decision is that each of the EBSS, CESS, STPIS and DMIAM, should apply to AusNet Services for the 2022–27 regulatory control period.

We discuss our draft decisions on each incentive scheme further in attachments 8 (EBSS), 9 (CESS), 10 (STPIS) and 11 (DMIAM).

4 The National Electricity Law and Rules

The NEL and NER provide the regulatory framework governing electricity networks. Our work under this framework is guided by the National Electricity Objective (NEO).⁵⁶

“...to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to—

(a) price, quality, safety, reliability and security of supply of electricity; and

(b) the reliability, safety and security of the national electricity system.”

The NEL requires us to make our decision in a manner that contributes, or is likely to contribute, to achieving the NEO.⁵⁷ The focus of the NEO is on promoting efficient investment in, and operation and use of, electricity services (rather than assets) in the long term interests of consumers.⁵⁸ This is not delivered by any one of the NEO’s factors in isolation, but rather by balancing them in reaching a regulatory decision.⁵⁹

Electricity determinations are complex decisions. In most cases, the provisions of the NER do not point to a single answer, either for our decision as a whole or in respect of particular components. They require us to exercise our regulatory judgement. Where there are choices to be made among several plausible alternatives, we have selected what we are satisfied would result in an overall decision that contributes to the achievement of the NEO to the greatest degree.⁶⁰

Our determinations are predicated on a number of constituent decisions that we are required to make.⁶¹ These are set out in appendix A and the relevant attachments. In coming to a decision that contributes to the achievement of the NEO, we have considered interrelationships of the constituent components of our draft decision in the relevant attachments. Examples include:

- underlying drivers and context which are likely to affect many constituent components of our decision. For example, forecast demand affects the efficient levels of capex and opex in the regulatory control period (see attachments 5 and 6)
- direct mathematical links between different components of a decision. For example, the level of gamma has an impact on the appropriate tax allowance; the benchmark efficient entity's debt to equity ratio has a direct effect on the cost

⁵⁶ NEL, s. 7.

⁵⁷ NEL, section 16(1)(a).

⁵⁸ This is also the view of the Australian Energy Markets Commission (the AEMC). See, for example, the AEMC, *‘Applying the Energy Objectives: A guide for stakeholders’*, 1 December 2016, p. 5.

⁵⁹ Hansard, *SA House of Assembly*, 26 September 2013, p. 7173. See also the AEMC, *‘Applying the Energy Objectives: A guide for stakeholders’*, 1 December 2016, pp. 7–8.

⁶⁰ NEL, s. 16(1)(d).

⁶¹ NER, cl. 6A.14.1.

of equity, the cost of debt, and the overall vanilla rate of return (see attachments 3 and 7)

- trade-offs between different components of revenue. For example, undertaking a particular capex project may affect the need for opex or vice versa (see attachments 5 and 6).

In general, we consider that the long-term interests of consumers are best served where consumers receive a reasonable level of safe and reliable service that they value at least cost in the long run.⁶² A decision that places too much emphasis on short term considerations may not lead to the best overall outcomes for consumers once the longer term implications of that decision are taken into account.⁶³

There may be a range of economically efficient decisions that we could make in a revenue determination, each with different implications for the long term interests of consumers.⁶⁴ A particular economically efficient outcome may nevertheless not be in the long term interests of consumers, depending on how prices are structured and risks allocated within the market.⁶⁵ There are also a range of outcomes that are unlikely to advance the NEO, or advance the NEO to the degree than others would. For example, we consider that:

- the long term interests of consumers would not be advanced if we encourage overinvestment which results in prices so high that consumers are unwilling or unable to efficiently use the network⁶⁶
- equally, the long-term interests of consumers would not be advanced if allowed revenues result in prices so low that investors do not invest to sufficiently maintain the appropriate quality and level of service, and where customers are making more use of the network than is sustainable leading to safety, security and reliability concerns.⁶⁷

⁶² Hansard, *SA House of Assembly*, 9 February 2005, p. 1452.

⁶³ See, for example, the AEMC, *'Applying the Energy Objectives: A guide for stakeholders'*, 1 December 2016, pp. 6–7.

⁶⁴ *Re Michael: Ex parte Epic Energy* [2002] WASCA 231 at [143].

⁶⁵ See, for example, the AEMC, *'Applying the Energy Objectives: A guide for stakeholders'*, 1 December 2016, p. 5.

⁶⁶ NEL, s. 7A(7).

⁶⁷ NEL, s. 7A(6).

A Constituent decisions

Our draft decision on AusNet Services' transmission determination includes the following constituent components:

Constituent component

In accordance with clause 6A.14.1(1)(i) of the NER, the AER's draft decision is not to approve the total revenue cap set out in AusNet Services' building block proposal. Our draft decision on AusNet Services' total revenue cap is \$2837.8 million (\$nominal, smoothed) for the 2022–27 regulatory control period. This decision is discussed in Attachment 1 of this draft decision.

In accordance with clause 6A.14.1(1)(ii) of the NER, the AER's draft decision is not to approve the maximum allowed revenue (MAR) for each regulatory year of the regulatory control period set out in AusNet Services' building block proposal. Our decision on AusNet Services' MAR for each year of the 2022–27 regulatory control period is set out in Attachment 1 of this draft decision.

In accordance with clause 6A.14.1(1)(iii) of the NER, the AER's draft decision is to apply the service component, network capability component and market impact component of Version 5 of the service target performance incentive scheme (STPIS) to AusNet Services for the 2022–27 regulatory control period. The values and parameters of the STPIS that are approved by the AER are set out in Attachment 10 of this draft decision.

In accordance with clause 6A.14.1(1)(iv) of the NER, the AER's draft decision on the values that are to be attributed to the parameters for the efficiency benefit sharing scheme (EBSS) that will apply to AusNet Services in respect of the 2022–27 regulatory control period are set out in Attachment 8 of this draft decision.

In accordance with clause 6A.14.1(1)(v) of the NER, the AER's draft decision is to approve the commencement and length of the regulatory control period as AusNet Services proposed in its revenue proposal. The regulatory control period will commence on 1 April 2022 and the length of this period is five years, expiring on 31 March 2027.

In accordance with clause 6A.14.1(2)(ii) of the NER and acting in accordance with clause 6A.6.7(c), the AER's draft decision is to not accept AusNet Services' proposed total forecast capital expenditure of \$797.7 million (\$2021–22). Our draft decision therefore includes a substitute estimate of AusNet Services total forecast capex for the 2022–27 regulatory control period of \$753.8 million (\$2021–22). The reasons for our draft decision are set out in Attachment 5 of this draft decision.

In accordance with clause 6A.14.1(3)(ii) of the NER and acting in accordance with clause 6A.6.6(d), the AER's draft decision is to not accept AusNet Services' proposed total forecast operating expenditure inclusive of debt raising costs of \$1422.8 million (\$2021–22). Our draft decision therefore includes a substitute estimate of AusNet Services' total forecast opex for the 2022–27 regulatory control period of \$1318.6 million (\$2021–22). The reasons for our draft decision are set out in Attachment 6 of this draft decision.

In respect of clause 6A.14.1(4) of the NER, AusNet Services did not propose any contingent projects.

Constituent component

In accordance with clause 6A.14.1(5A) of the NER, the AER's draft decision is that version 1 of the capital expenditure sharing scheme (CESS) as set out the Capital Expenditure Incentives Guideline will apply to AusNet Services in the 2022–27 regulatory control period. This is discussed in Attachment 9 of this draft decision.

In accordance with clause 6A.14.1(5A) of the NER, the AER's draft decision is that the demand management innovation allowance mechanism (DMIAM) for electricity transmission networks will apply to AusNet Services in the 2022–27 regulatory control period. This is set out in Attachment 11 of this draft decision.

In accordance with clause 6A.14.1(5B) and 6A.6.2 of the NER, the AER's draft decision is that the allowed rate of return for the 2022–23 regulatory year is 4.76 per cent (nominal vanilla), as set out in Attachment 3 of this draft decision. The rate of return for the remaining regulatory years 2023–27 will be updated annually because our decision is to apply a trailing average portfolio approach to estimating debt which incorporates annual updating of the allowed return on debt.

In accordance with clause 6A.14.1(5C) of the NER, the AER's draft decision is that the value of imputation credits as referred to in clause 6A.6.4 is 0.585. This is set out in Attachment 3 of this draft decision.

In accordance with clause 6A.14.1(5D) of the NER, the AER's draft decision, in accordance with clause 6A.6.1 and schedule 6A.2, is that the opening regulatory asset base (RAB) as at the commencement of the 2022–27 regulatory control period, being 1 April 2022, is \$3545.9 million (\$nominal). This is set out in Attachment 2 of this draft decision.

In accordance with clause 6A.14.1(5E) of the NER, the AER's draft decision is that the depreciation approach based on forecast capex (forecast depreciation) is to be used to establish the RAB at the commencement of AusNet Services' regulatory control period as at 1 April 2027. This is discussed in Attachment 2 of this draft decision.

In accordance with clause 6A.14.1(6) of the NER, the AER's draft decision is to not approve AusNet Services' proposed negotiating framework. This is set out in Attachment 14 of this draft decision.

In accordance with clause 6A.14.1(7) of the NER, the AER's draft decision specifies the Negotiated Transmission Service Criteria for AusNet Services. This is set out in Attachment 14 of this draft decision.

In accordance with clause 6A.14.1(8) of the NER, the AER's draft decision is to approve AusNet Services' proposed pricing methodology. This is set out in Attachment 12 of this draft decision.

Constituent component

In accordance with clause 6A.14.1(9) of the NER, the AER's draft decision is to apply the following nominated pass through events to apply to AusNet Services for the 2022–27 regulatory control period in accordance with 6A.7.3(a1)(5):

- insurance coverage event
- terrorism event
- natural disaster event
- insurer credit risk event
- Victorian Energy Minister's power to direct augmentation event.

These events have the definitions set out in Attachment 13 of this draft decision.

B List of submissions

We received two submission in response to AusNet Services' revenue proposal. These are listed below.

Submission from	Date received
Consumer Challenge Panel, sub-panel 23	12 February 2021
AusNet Services	12 February 2021

C Consumer engagement framework

The following table represented the framework outlined in our draft decision for considering consumer engagement.⁶⁸

Element	Examples of how this could be assessed
Nature of engagement	<ul style="list-style-type: none"> • Consumers partner in forming the proposal rather than asked for feedback on service provider’s proposal • Relevant skills and experience of the consumers, representatives, and advocates • Consumers provided with impartial support to engage with energy sector issues • Sincerity of engagement with consumers • Independence of consumers and their funding • Multiple channels used to engage with a range of consumers across a service provider’s consumer base
Breadth and depth	<ul style="list-style-type: none"> • Clear identification of topics for engagement and how these will feed into the regulatory proposal • Consumers consulted on broad range of topics • Consumers able to influence topics for engagement • Consumers encouraged to test the assumptions and strategies underpinning the proposal • Consumers were able to access and resource independent research and engagement
Clearly evidenced impact	<ul style="list-style-type: none"> • Proposal clearly tied to expressed views of consumers • High level of business engagement, e.g. consumers given access to the service provider’s CEO and/or board • Service providers responding to consumer views rather than just recording them • Impact of engagement can be clearly identified • Submissions on proposal show consumers feel the impact is consistent with their expectations
Proof point	<ul style="list-style-type: none"> • Reasonable opex and capex allowances proposed <ul style="list-style-type: none"> ○ In line with, or lower than, historical expenditure ○ In line with, or lower than, our top down analysis of appropriate expenditure ○ If not in line with top down, can be explained through bottom up category analysis

⁶⁸ AER, *Final decision, Jemena distribution determination 2021–26, Overview, Appendix C*, April 2021, p. 48.

Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
capex	capital expenditure
CESS	capital expenditure sharing scheme
CPI	consumer price index
CCP23	Consumer Challenge Panel, sub-panel 23
DMIAM	demand management innovation allowance mechanism
EBSS	efficiency benefit sharing scheme
ISP	AEMO's integrated system plan
MAR	maximum allowed revenue
NEL	national electricity law
NEM	national electricity market
NEO	national electricity objective
NER	national electricity rules
NSP	network service provider
opex	operating expenditure
PV	photovoltaic
PTRM	post-tax revenue model
RAB	regulatory asset base
RBA	Reserve Bank of Australia
RIN	regulatory information notice
RFM	roll forward model
STPIS	service target performance incentive scheme
TNSP	transmission network service provider
WACC	weighted average cost of capital