

# Draft decision: AusNet Services (transmission) 2017–22

We have made a draft revenue decision for AusNet Services, Victoria's electricity transmission network operator. Our draft decision allows AusNet Services to recover \$2695.0 million (\$nominal) from its customers over five years commencing 1 April 2017.

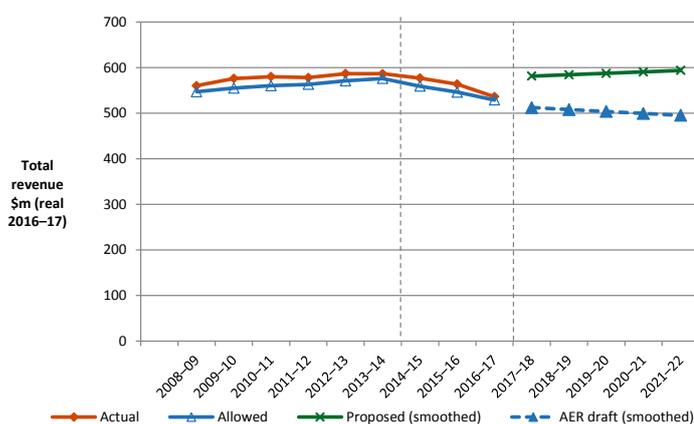
## Overview

The Australian Energy Regulator (AER) regulates the revenues of AusNet Services by setting the annual revenue requirement it may recover from its customers.

Our draft decision allows AusNet Services to recover \$2695.0 million (\$nominal) from its customers over five years commencing 1 April 2017. If we had accepted AusNet Services' proposal, it would have been permitted to recover \$3160.5 million (\$nominal) over the 2017–22 regulatory control period. Our draft decision is for 14.7 per cent less revenue than AusNet Services' proposed.

The figure below shows the difference between AusNet Services' proposed revenue, and what we have allowed for each year of the regulatory period.

**AusNet Services' past and proposed total revenue and AER draft decision revenue allowance (\$million, 2016–17)**



The revenue we determine affects the transmission component of a customer's electricity bill. Transmission charges may make up approximately 5 per cent of the bill for one of Victoria's typical residential customers.

Other components of customer bills include the cost of generation, distribution, network charges and retailer costs. The AER does not set retail prices.

### Estimated impact on customer bills

If implemented, we expect that our draft decision will result in the transmission component of electricity bills in Victoria remaining stable over the 2017-22 regulatory period.

### Key elements of our decision

We based our assessment of AusNet Services' proposed revenue on a number of components. These include expenditures to maintain and operate the network, and the return to shareholders on their investment. Together, these determine the revenue AusNet Services may recover from its customers.

Three components of our draft decision drive most of the difference between AusNet Services' proposed revenue and our draft decision: rate of return, depreciation on assets and corporate income tax.

We discuss each of these below.

### Rate of return

Significant investment is required to build a transmission network. The return AusNet Services must pay lenders and investors is referred to as the rate of return. Even a small difference in the rate of return can have a big impact on revenues.

Our draft decision sets the allowed rate of return (or 'cost of capital') at 6.16 per cent for 2017–18. We have not accepted AusNet Services' proposed 7.22 per cent.

We consider that AusNet Services has sought a rate of return that is higher than necessary given the current investment environment and low interest rates compared to previous years. This translates to lower financing costs necessary to attract efficient investment.

We have not accepted the methodology proposed by AusNet Services to set its rate of return. Instead, we have used the methodology we developed through extensive consultation during our Better Regulation program in 2013. We consider that our approach provides for a rate of return that better reflects the allowed rate of return objective.

The lower rate of return in this decision will reduce AusNet Services' average annual revenue requirement compared to the previous regulatory period.

### **Depreciation of assets**

Depreciation is the amount that AusNet Services recovers to pay for the real original cost of an asset over time. AusNet Services proposed to change the depreciation method for all new assets being acquired in the 2017–22 regulatory control period. It proposed using a diminishing value (DV) depreciation method for new assets, while maintaining a straight-line (SL) depreciation method for existing assets.

The DV method results in higher depreciation in the early years of an asset's life and lower depreciation in the latter years. That is, network customers pay off a higher proportion of the initial cost of the asset in the early years compared to the typical straight-line depreciation method.

Our draft decision does not accept AusNet Services proposal to apply the DV method for depreciating new assets as we do not consider that this method results in a depreciation profile that reflects the nature of these assets over their economic lives. Instead we have applied the SL depreciation method for both new and existing assets, resulting in a reduced depreciation allowance over the 2017–22 regulatory control period.

### **Corporate income tax**

We are required to make a decision on the estimated cost of corporate income tax for AusNet Services' 2017–22 regulatory control period. This allows AusNet Services to recover the costs associated with the estimated corporate income tax payable during the 2017–22 regulatory control period.

Under the post-tax framework, a corporate income tax allowance is calculated as part of the building block assessment using our post-tax revenue model (PTRM). The reduction between AusNet Services' proposal and our draft decision reflects our amendments to some of AusNet Services' proposed inputs for forecasting the cost of corporate income tax. Changes to building block costs also affect revenues, which in turn impact the tax calculation.

### **More information about our consultation process**

AusNet Services may submit a revised proposal in response to our draft decision by 21 September 2016. Stakeholders may make written submissions on our draft decision by the same date, 21 September 2016. Stakeholders may also file submissions on AusNet Services' revised proposal by 13 October 2016. Our final decision is due for release by the end of January 2017.

More information on AusNet Services' proposal, our draft decision and how to make a submission is on our website: [www.aer.gov.au](http://www.aer.gov.au).