

Draft decision: TransGrid (transmission) 2015–18

We have made a draft decision for the principal transmission network operator in New South Wales, TransGrid. Our draft decision allows TransGrid to recover \$2310.5 million (\$nominal) from its customers over three years commencing 1 July 2015.

Overview

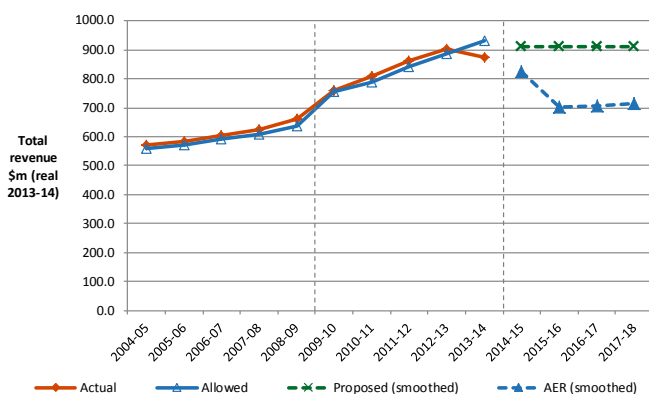
TransGrid is the principal transmission network service provider (TNSP) in New South Wales (NSW). It owns and operates the 'towers and wires' that deliver electricity from generators to consumers in cities and towns. We, the Australian Energy Regulator (AER) regulate the revenues of TransGrid and other TNSPs in eastern and southern Australia under the National Electricity Law (NEL) and National Electricity Rules (NER).

Our draft decision provides that TransGrid will recover \$2310.5 million in the 2015-18 regulatory control period. As a result, based on estimated energy use, we expect the average residential customer's annual bill to fall by \$21 in 2015-16 in the ACT, and \$24 in NSW.

We regulate TNSPs by setting the maximum allowed revenue (MAR) they can recover from their customers. Our draft decision allows TransGrid to recover \$2310.5 million from its customers over the 2015-18 regulatory control period.

If we had accepted TransGrid's proposal, it would have recovered \$3046.2 million (\$ nominal) over the 2015-18 regulatory control period. The difference between TransGrid's revenue from 2009-14, its proposed revenue, and what we have allowed in our draft decision are shown below.

TransGrid's past total revenue, proposed total revenue and AER draft decision revenue allowance (\$ million, 2013–14)



The revenue we determine affects the transmission component of a customer's final bill. Generally, transmission charges make up about 7 per cent of a typical residential customer's final bill in NSW but for other large customers it can be more significant. Other components in consumer bills include the cost of generation, distribution network charges, and retailer costs.

In November 2012 major changes were introduced to the regulation of TNSPs under the NER. TransGrid's transmission determination was due to commence on 1 July 2014, and apply for a period of five years. So that the new rules could be applied to this decision, transitional rules required two regulatory control periods:

- A transitional regulatory control period from 1 July 2014 to 30 June 2015; and
- A subsequent regulatory control period commencing 1 July 2015.

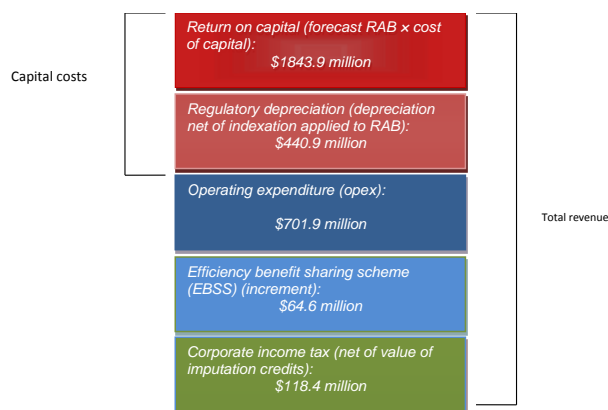
We made a fast-tracked placeholder determination for the transitional regulatory control period on 28 March 2014. That determination will be adjusted (or 'trued up') in our determination for the subsequent regulatory control period, which is the subject of this draft decision.

Our assessment

In making our assessment, a TNSP first proposes its forecast revenue requirement. This is based on an estimate of a number of cost categories called 'building blocks'. We also include the gains (or losses) arising from our efficiency benefit sharing incentive scheme which are referred to as EBSS carryover amounts.

Together, the building blocks add to the MAR TransGrid can earn through levying transmission charges on customers. In this way, it should recover no more than the efficient cost of providing transmission services to its customers.

Draft decision: Building blocks 2014-18 (\$ nominal)



We also apply our service target performance incentive scheme (STPIS) to incentivise TNSPs to maintain and improve service levels.

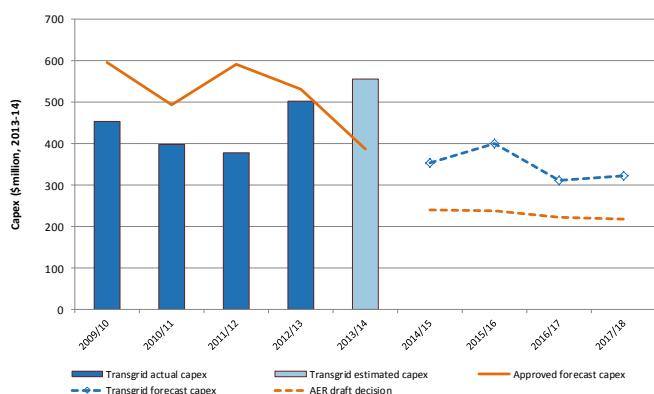
Capital expenditure

We did not accept TransGrid's proposed forecast capital expenditure (capex) of \$1387.4 million (\$2013-14). We estimated a substitute forecast of \$922.3 million (\$2013-14).

TransGrid's forecast capex includes less expenditure on new assets to grow its network than in previous periods, because of slower demand growth. However, it includes expenditure TransGrid will need to replace existing assets where they are no longer in acceptable condition. This helps to maintain reliable electricity supply to TransGrid's customers.

Capex refers to the cost of building new facilities or replacing existing infrastructure. Factors that influence the required level of capex include the age and condition of existing assets.

AER draft decision compared to TransGrid's past and proposed capex (\$million, 2013-14)



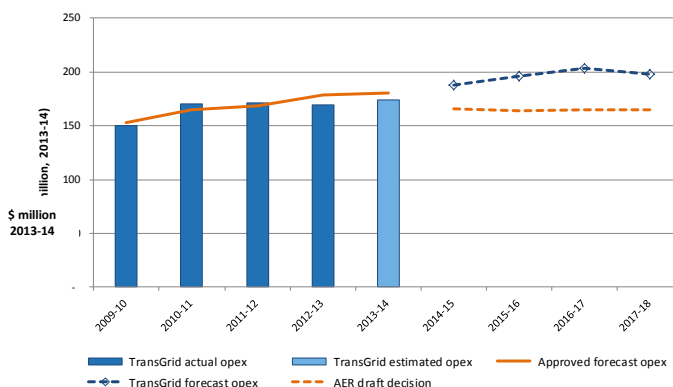
Operating expenditure

We did not accept TransGrid's proposed \$784.5 million (\$2013-14) operating expenditure (opex) forecast. We instead estimated a substitute of \$659.7 million (\$2013-14).

Opex refers to the non-capital cost of running a business. It includes controllable and non-controllable costs.

TransGrid proposed increases to several parts of its opex over the next three years. Instead, our draft decision allows TransGrid around the same overall level of opex it has spent in the last period, and encourages TransGrid to find further efficiencies within this allowance. Our EBSS allows TransGrid to share any gains or losses with its customers.

AER draft decision compared to TransGrid's past and proposed opex (\$million, 2013-14)



Rate of return

Our final decision sets the allowed rate of return (or 'cost of capital') at 7.24 per cent. In comparison, it was 10.05 per cent during the previous regulatory control period.

The investment environment has improved since our previous decision, which was made during the height of uncertainty surrounding the global financial crisis. The lower rate of return in this decision will reduce TransGrid's average annual revenue requirements compared to the past. This should help reduce electricity prices for consumers in the forthcoming regulatory control period.

Significant investment is required to build a transmission network. The return TransGrid 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.

More information about our consultation process

TransGrid may submit a revised proposal in response to our draft decision, no later than 14 January 2015. Stakeholders will also be able to make submissions on our draft decision and TransGrid's revised proposal, by 31 January 2015.

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