Draft decision: Endeavour Energy 2019–24

We have made a draft distribution determination for Endeavour Energy, the electricity distribution network operator for Sydney's greater west, the Blue Mountains, Southern Highlands, the Illawarra and South Coast. Our draft decision would allow Endeavour Energy to recover $4413 million ($nominal) in revenue from its customers over five years commencing 1 July 2019.

Estimated impact on customer bills ($nominal)

The distribution network tariffs that will be set by reference to our final decision are only one contributor to electricity bills, and make up around 30 per cent of the total retail electricity bills Endeavour Energy's customers pay.

Holding all other components of the bill constant, the average annual electricity bill for a residential or small business customer on Endeavour Energy's distribution network would be about 0.4 per cent higher by the end of the 2019–24 regulatory control period.

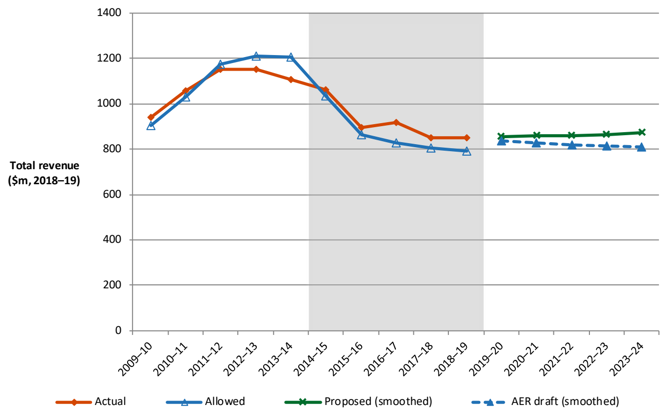
For Endeavour Energy's residential and small business customers, this suggests that the average annual electricity bill would be $6 and $12 higher, respectively, by the end of the 2019–24 regulatory control period.

Overview

We, the Australian Energy Regulator (AER), regulate the revenues of Endeavour Energy by setting the total revenue it may recover from its customers.

Our draft decision allows for a 5 per cent real reduction in Endeavour Energy’s total allowed revenue from the current period.

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



Key elements of our draft decision

Endeavour Energy's proposal was made following a period of engagement with consumers on how best to address consumer priorities of affordability, reliability and safety. This engagement included a series of expenditure 'deep dives' undertaken by Endeavour Energy as part of our agreement to extend the time for submission of its proposal from 31 January to 30 April 2018. This engagement was a significant improvement since our last decision for Endeavour Energy in 2015.

However, some areas of contention identified by consumer groups in the course of Endeavour Energy's engagement remained at the time its proposal was submitted.

Since submission of its initial proposal Endeavour Energy has continued to engage with us and with key stakeholders to understand and address concerns with its forecast increase in capital expenditure (capex) for 2019–24 in particular.

In many respects we agree with Endeavour Energy on the key drivers influencing its revenue requirement for 2019–24. However, our draft decision does not reflect the total revenue proposed by Endeavour Energy. The total revenue in this draft decision is 5.1 per cent lower than in Endeavour's proposal.

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

Next steps

Endeavour Energy’s revised regulatory proposal is due by 8 January 2019.

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

Rate of return and gamma

The biggest contributor to the difference between our draft decision and Endeavour Energy's proposal is our proposed change to the rate of return (and therefore the return on capital).

Our draft decision adopts the approach proposed in our draft 2018 rate of return guideline to calculate a rate of return of 5.96 per cent compared to Endeavour Energy's proposed 6.11 per cent (which was based on our current, 2013 guideline).

Also reflecting our draft 2018 rate of return guideline, our draft decision adopts a value of imputation credits (gamma) of 0.5 compared to Endeavour Energy's proposed 0.4 (again based on our 2013 guideline and approach), which has contributed to the reduction in the corporate income tax allowance relative to Endeavour Energy's proposal.

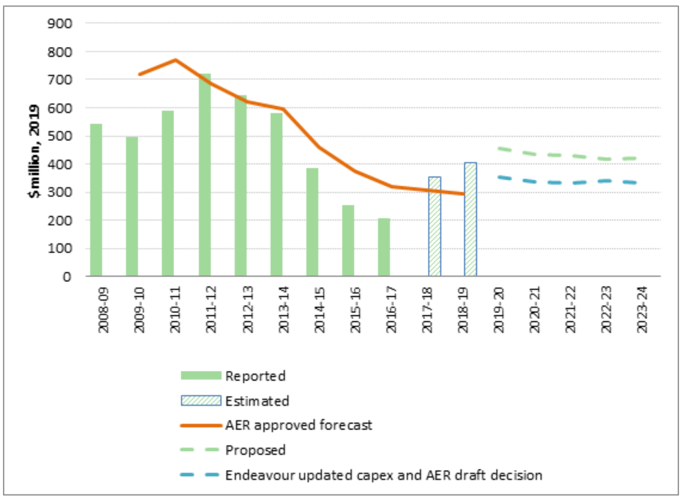
Consultation on our draft 2018 guideline is ongoing, and is expected to conclude in December 2018. Legislation before the South Australian Parliament at the time of this draft decision will (if passed) make our final 2018 rate of return guideline binding on this and other decisions.

Capital expenditure (capex)

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

Our draft decision on Endeavour Energy's revenue includes total forecast capex of $1.7 billion ($2018–19) for 2019–24. This change in Endeavour Energy’s capex over time is illustrated in the figure below.

Endeavour Energy’s past and proposed capex and AER draft decision capex allowance ($million, 2018–19)



Our draft decision substitutes a capex forecast that is 20 per cent lower than the $2.13 billion in Endeavour Energy's April 2018 proposal. We identified a number of concerns with that proposal, many of which were shared by stakeholders.

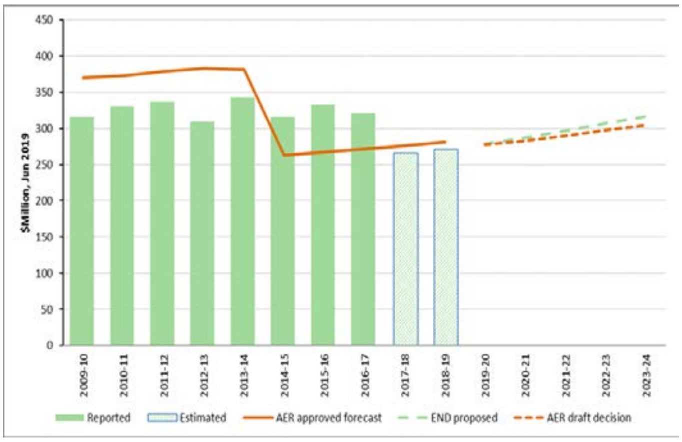
Our draft decision takes into account new information provided by Endeavour Energy in response to continued engagement on its capex forecast following submission of its proposal. This included an updated capex forecast provided on 30 August 2018. That updated forecast better reflects the efficiency gains achieved in the current period and has formed the basis of the total forecast capex we have adopted for the purpose of this draft decision.

Operating expenditure

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

Our draft decision is to include total forecast opex of $1468.5 million ($2018–19) in Endeavour Energy's revenue for the 2019–24 regulatory control period. The total forecast opex in this draft decision is around 2.5 per cent lower than Endeavour Energy's opex in the current period.

Endeavour Energy’s past and proposed opex and AER draft decision opex allowance ($million, 2018–19)



The total opex forecast we have included in this draft decision is $35.5 million (2.4 per cent) lower than Endeavour Energy's proposed forecast of $1504.0 million.

Over the current period we have seen Endeavour Energy make significant progress in improving its efficiency. Where our last decision expressed concerns that its opex was materially above efficient levels, we are now in a position to accept Endeavour Energy's revealed opex as a starting point for its forecast expenditure for the next five years. However, opex is another area in which we require further information before we can accept Endeavour Energy's proposed forecast for 2019–24. This includes further consideration of how changes in productivity over time should be reflected in forecast opex.

For more information:

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