Final decision:
Ergon Energy (distribution) 2015–20

We have made a final decision for Ergon Energy, an electricity distribution network operator in Queensland. Our final decision allows Ergon Energy to recover $6295.4 million ($nominal) from its customers over five years commencing 1 July 2015.

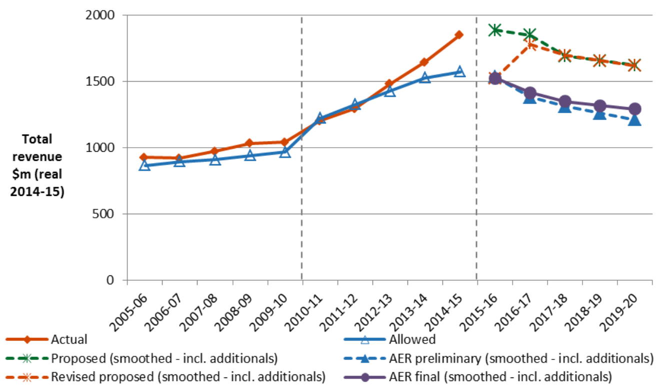
Overview

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

Our final decision allows Ergon Energy to recover $6295.4 million ($nominal) from its customers over five years commencing 1 July 2015. If we had accepted Ergon Energy's revised proposal, it would have recovered $7798.2 million ($ nominal) over the 2015–20 regulatory control period. Our final decision is for 19.3 per cent less revenue than Ergon Energy's revised proposal.

The figure below shows the difference between Ergon Energy's proposed revenue, and what we have allowed for each year of the final decision.

Ergon Energy's past total revenue, proposed total revenue and AER final decision revenue allowance ($ million, 2014–15)



In April 2015, we published our preliminary decision for Ergon Energy which took effect on 1 July 2015. Our preliminary decision formed the basis for approving prices for 1 July 2015 to 30 June 2016. Our final decision comes into effect from 1 July 2016. Our final decision incorporates a 'true-up' of Ergon Energy's revenue for 2015–16 and spreads the adjustment over the remaining four years.

The revenue we determine affects the distribution component of a customer's electricity bill. Distribution charges make up approximately 42 per cent of the bill for one of Ergon Energy's typical residential customers. Other components in customer bills include the cost of generation, transmission, network charges and retailer costs. The AER does not set retail prices.

Within the smoothed revenues presented, we have included additional adjustments to the annual revenues to be recovered from electricity customers. These include the costs relating to the Queensland Government's Solar Bonus Scheme, capital contributions, and under- and over-recoveries. The most significant of these is the Solar Bonus Scheme feed-in tariffs (FiT). Neither Ergon Energy nor we are able to affect the amount of the FiT costs to be recovered from network charges. However, we are able to smooth the impacts to minimise price fluctuations.

A further aspect of our decision for Ergon Energy's small customers (less than 100 MWh) is that retail electricity prices are subsidised under the Queensland Government's uniform tariff policy. In the absence of the uniform tariff policy, Ergon Energy's network charges would be expected to flow through to all of its customers.

Estimated impact on customer bills

The Queensland Government uniform tariff policy means that the bill impact for customers in Ergon Energy area will instead reflect network charges of Energex. Based on our final decision for Energex's network charges, we would expect average annual electricity bills for residential customers in Ergon Energy's distribution area to reduce by $17 (or —1.2 per cent) in 2016–17, followed by reductions of $21, $17 and $14 in subsequent years. For small business customers, we estimate a reduction of $36 (or —1.2 per cent) in 2016–17, followed by reductions of $44, $36 and $30 in subsequent years. Our preliminary decision locked in the bill reductions in 2015-16 of $25 and $51 for residential and small business customers, respectively.

These are estimates based on the data about energy use in Queensland. Other factors can affect a customer's electricity bill, such as the wholesale price of electricity. You can read more about what makes up the energy prices on customers' bills on our website: www.aer.gov.au/Consumers.

Key elements of our decision

Our assessment of Ergon Energy's proposed revenue is based on a number of components. These include expenditure to maintain and operate the network and the return to shareholders on their investment. Together, these determine the revenue Ergon Energy may recover from its customers.

Three components of our final decision drive most of the difference between Ergon Energy's revised proposal and our final decision: rate of return, operating expenditure (opex) and capital expenditure (capex). We discuss each of these below.

Rate of return

Significant investment is required to build a distribution network. The return Ergon Energy 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 final decision sets the allowed rate of return (or 'cost of capital') at 6.01 per cent for 2015–16. We have not accepted Ergon Energy's revised proposal of 7.41 per cent.

The investment environment has improved since our previous Queensland distribution decision in 2010, which was made during the period of uncertainty surrounding the global financial crisis. This improved investment environment translates to lower financing costs necessary to attract efficient investment. We consider that Ergon Energy has sought a rate of return that is higher than necessary given the current investment environment.

In our final decision we did not accept the methodology proposed by Ergon Energy to set its rate of return. Instead, we have used our methodology developed with 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.

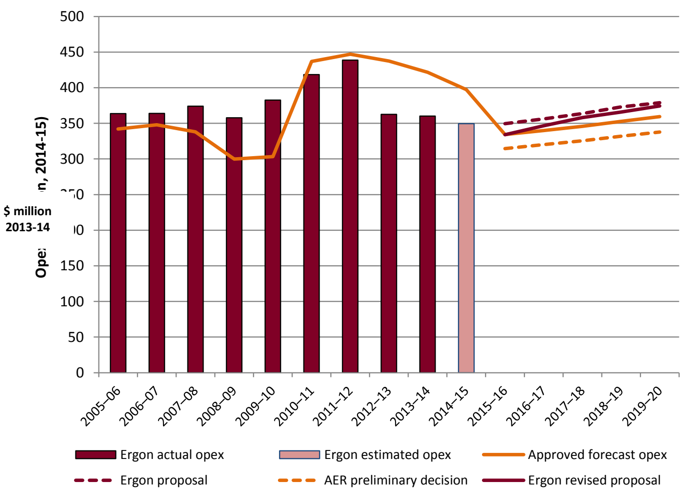
The lower rate of return in this decision will reduce Ergon Energy's average annual revenue requirement compared to the past.

Operating expenditure

Opex includes forecast operating, maintenance and other non-capital costs that Ergon Energy is likely to require during the 2015–20 regulatory control period for the efficient operation of its network.

Our final decision allows Ergon Energy to recover $1757.9 million ($2014–15) for opex. This is 4.5 per cent lower than the $1841.8 million Ergon Energy proposed.

AER final decision compared to Ergon Energy's past and proposed opex ($million, 2014-15)



We must be satisfied that the level of opex proposed by Ergon Energy reflects the opex criteria: the costs that a prudent operator—with efficient costs and a realistic expectation of demand and cost inputs—would need to operate its network safely and comply with its obligations and service standards.

We are not satisfied that Ergon Energy's proposed forecast opex reasonably reflects the opex criteria. While we have determined that Ergon Energy's base year opex is not materially inefficient, we have not accepted several of its proposed opex step changes (which are increases in revenue for changed regulatory or environmental conditions). We consider Ergon Energy has not demonstrated that such revenue increases are necessary to provide safe and reliable distribution services.

Capital expenditure

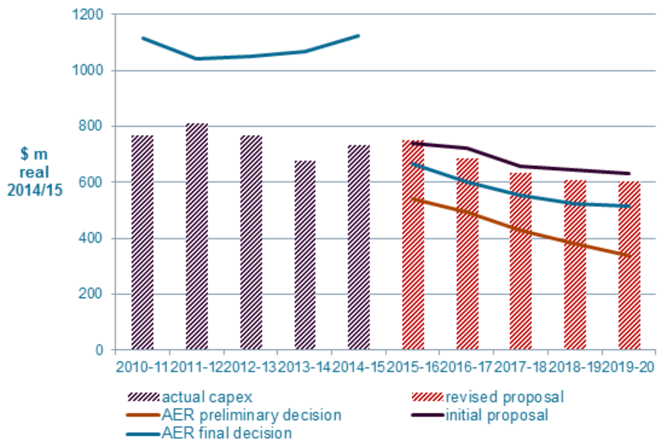
Capex refers to the cost of building new facilities or replacing existing infrastructure. Factors that influence our required level of capex include the age and condition of existing assets.

We must be satisfied that the level of capex proposed by Ergon Energy reflects the capex criteria: the costs that a prudent operator—with efficient costs and a realistic expectation of demand and cost inputs—would need to operate its network safely and comply with its obligations and service standards.

We have estimated total forecast capex of $2858.1 million ($2014–15) for Ergon Energy's 2015–20 regulatory control period. This is 12.9 per cent lower than Ergon Energy's proposal of $3282.4 million for capex.

The key difference between our substitute capex forecast and Ergon Energy's proposal is lower expenditure on replacement capex and expansion of the network.

AER final decision compared to Ergon Energy's past and proposed capex ($million, 2014-15)



For more information:

More information on our final decision can be found on our website: [www.aer.gov.au.](http://www.aer.gov.au)