AUSTRALIAN ENERGY REGULATOR

Final decision: Essential Energy 2019–24

We have made a final revenue determination for Essential Energy, the electricity distribution network operator in rural and regional NSW. Our final decision allows Essential Energy to recover $5,079.3 million ($ nominal) in revenue from its customers over five years, from 1 July 2019 to 30 June 2024.

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 34 per cent of the total retail electricity bills Essential Energy's customers pay.

Under our final decision, the average annual electricity bill for a residential or small business customer on Essential Energy's network is estimated to be around 1.2 per cent higher by 30 June 2024 compared to the current 2018–19 level, holding all other components of the bill constant.

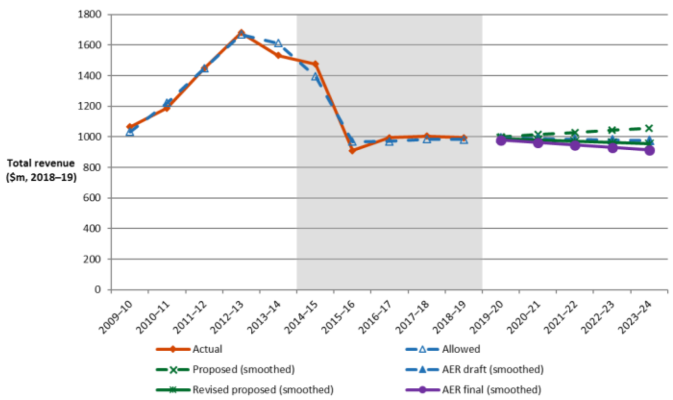
This suggests that the average annual electricity bill for a residential and small business customer on Essential Energy's network is estimated to be around $24 and $111 higher, respectively, by the end of the 2019–24 period.

Overview

The Australian Energy Regulator (AER) regulates Essential Energy's revenue by setting the total revenue it may recover from its customers.

Our final decision allows for a 10.8 per cent real reduction in Essential Energy's total revenue from the current period.

Essential Energy's past and proposed total revenue, and AER final decision revenue allowance ($ million, 2018–19)



Our final decision is $212.9 million ($ nominal) lower than our draft decision, and $136.7 million ($ nominal) lower than Essential Energy's revised proposal.

Having assessed Essential Energy's revised regulatory proposal, we consider our final decision is justified as it:

- builds on the operational efficiencies Essential Energy has achieved in response to our lower approved revenues for the current period and locks in ongoing efficiency gains for future periods for the benefit of customers
- is balanced against the additional costs associated with past capital investment to meet NSW Government licence conditions for network security and reliability.

Our final decision, which largely accepts Essential Energy's revised proposal and is consistent with our draft decision, reflects not only the considerable efficiency gains Essential Energy has achieved over the current period, but also the strategies and initiatives it now proposes to deliver further efficiencies in expenditure and improvements in productivity over the 2019–24 period. This includes incorporating an operating expenditure productivity growth component of around three times greater than our standard approach for electricity distribution businesses. These savings are now locked in for consumers.

Essential Energy has set a high watermark level for its approach to consumer engagement. It consulted extensively with customers and consumer representatives and put forward initial and revised regulatory proposals which were both understood and accepted by stakeholders, despite increased costs. Essential Energy's stewardship of its regulatory proposal is a clear example of the value to a network service provider from a comprehensively designed and well implemented consumer engagement program, in terms of successful passage through the regulatory determination process with strong stakeholder support.

Previously, our draft decision noted that in a number of respects, we agreed with Essential Energy on the key drivers identified through its earlier stakeholder engagement as influencing its revenue requirement for the 2019–24 period. Few areas of difference remained following our draft decision, among which was the applicable rate of return which has since been settled as it is based on a binding instrument in this final decision.

Since our draft decision and prior to Essential Energy lodging its revised proposal, Essential Energy has continued to meaningfully engage with consumer groups and our staff to narrow or eliminate the few remaining areas of difference.

Our final decision also incorporates the revenue impact of our 2014–19 remade final decision for Essential Energy (remittal). We remade our decision in May 2018, following receipt of Essential Energy's remittal proposal. Under that decision, Essential Energy will return to customers from 1 July 2019 approximately $33.0 million ($2018–19) over the 2019–24 period.

Rate of return and gamma

In December 2018, the National Electricity Law and National Gas Law were amended to require us to make a binding rate of return instrument (2018 Instrument). As a binding instrument, it sets out the methodology for calculating the rate of return. The method must be capable of automatic application to all regulated network service providers without the exercise of discretion.

The 2018 Instrument specifies the return on debt as a formula, being the trailing average portfolio approach, and requires a business that is not already using a trailing average to transition to it over a 10-year period that is in the future.

As required under the National Electricity Rules, we have applied the 2018 Instrument and estimate an allowed rate of return of 5.76 per cent (nominal vanilla). Our final decision also applies a gamma value (imputation credits) of 0.585, as per the 2018 Instrument.

Essential Energy's revised proposal adopted the 2018 Instrument.

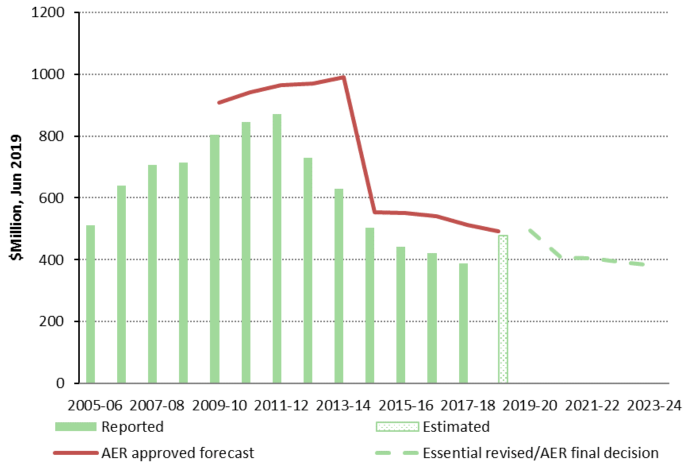
Capital expenditure (capex)

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 periods.

Capex is added to Essential Energy's regulatory asset base (RAB), which is used to determine the return on capital and regulatory depreciation (return of capital) '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 final decision on Essential Energy's revenue includes a total net capex forecast of $2,081.2 million ($2018–19) for 2019–24. This is 6.8 per cent lower than Essential Energy's actual and estimated net capex over the current period.

Essential Energy's past and proposed capex, and AER final decision capex allowance ($ million, 2018–19)



Our final decision accepts Essential Energy's revised total net capex forecast. We are satisfied that Essential Energy's revised total net capex forecast reasonably reflects the capex criteria and is consistent with the efficient costs that a prudent operator would incur in the 2019–24 period.

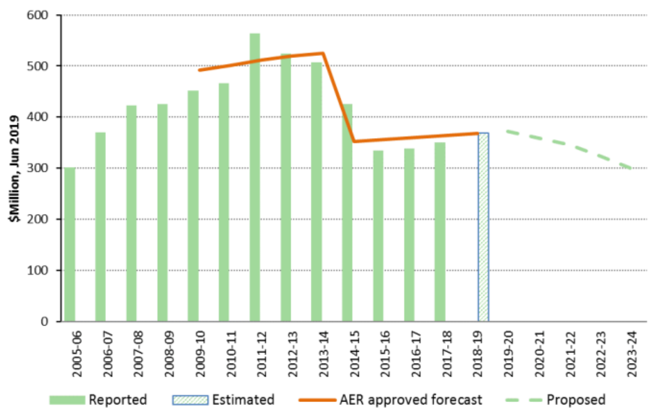
Operating expenditure (opex)

Opex refers to the operating, maintenance and other non-capital expenses incurred in the provision of network services.

Our final decision on Essential's revenue includes a total forecast opex of $1,718.4 million ($2018–19) for 2019–24. This is 6.6 per cent lower than Essential Energy's actual and estimated opex over the current period.

Our final decision accepts Essential Energy's revised opex forecast, which includes a 1.47 per cent per year productivity growth component. We are satisfied that Essential Energy's revised opex forecast reasonably reflects the opex criteria and is efficient.

Essential Energy's past and proposed opex, and AER final decision opex allowance ($ million, 2018–19)



For more information:

More information on our 2019–24 final decision and Essential Energy's revised proposal is on our website: www.aer.gov.au.