



# Final Decision

## Ausgrid 2014–19 electricity distribution determination

January 2019

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# 1 Executive Summary

The Australian Energy Regulator (AER) regulates energy markets and networks under national energy market legislation and rules. Our network regulatory functions, which relate to energy networks in all Australian states and territories, except Western Australia, include setting the amount of revenue that monopoly network businesses can recover from customers for using networks (electricity poles and wires and gas pipelines) that transport energy.

The National Electricity Law (NEL) and Rules (NER) provide the regulatory framework governing electricity networks. Our work under this framework is guided by the national electricity objective (NEO):<sup>1</sup>

“... to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, safety, reliability and security of supply of electricity and the reliability, safety and security of the national electricity system.”

This is our remade final decision on the distribution determination for NSW electricity distributor, Ausgrid, for the 2014-19 regulatory control period, commencing 1 July 2014 to 30 June 2019. Our remade final decision is unchanged from our remade draft decision.<sup>2</sup>

Our remade final decision is to accept Ausgrid’s Proposal, subject to certain modelling adjustments, to recover total revenues of \$9,126.3 million (\$ nominal) from consumers over the five-year 2014-19 regulatory control period.<sup>3,4</sup> The decision provides for a 2014-19 revenue that is largely in line with that which we determined was efficient in April 2015.<sup>5</sup> This provides consumers with stability over what they predicted they would have to pay; it keeps distribution network charges in line with current levels (in nominal terms).<sup>6</sup>

Our remade final decision for the 2014-19 regulatory control period will result in a revenue allowance of \$341.1 million (\$ nominal) above the revenue we approved in our 2015 final decision<sup>7</sup> that was set aside by the Tribunal. This will lead to an estimated \$310.9 million (\$ nominal) at 30 June 2019 being returned to consumers in the next (2019-24) regulatory

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<sup>1</sup> NEL, s. 7.

<sup>2</sup> AER, *Draft Decision Ausgrid 2014-19 distribution determination*, November 2018.

<sup>3</sup> Ausgrid, *Proposal for the remake of Ausgrid’s 2014-19 distribution determination*, 15 August 2018.

<sup>4</sup> The modelling adjustments that we have applied to the models that support Ausgrid’s Proposal are summarised in section 2 of this remade final decision, and set out in more detail in section 2 of our remade draft decision: AER, *Draft Decision Ausgrid 2014-19 distribution determination*, November 2018.

<sup>5</sup> AER, *Final decision, Ausgrid distribution determination 2015–16 to 2018–19*, April 2015.

<sup>6</sup> In May 2016, we accepted undertakings given by Ausgrid under section 59A of the NEL that set out how network revenues and tariffs will be determined in 2016–17. Ausgrid’s Network Use of System (NUoS) tariffs in 2016–17 were set at their 2015–16 approved tariffs adjusted for changes in the CPI. As of May 2017, the Full Federal Court had not yet handed down its decision, so we accepted further undertakings given by Ausgrid to establish new interim arrangements to govern the setting of network tariffs in 2017–18. As of March 2018, as the remittal process was not yet settled, we accepted further undertakings from Ausgrid for 2018-19. See *Open letter to stakeholders: Electricity network charges in the ACT and NSW from 1 July 2018*, 21 March 2018.

<sup>7</sup> In December 2015, we subsequently approved additional revenue of \$43.2 million (\$ nominal) in respect of a positive cost pass through for restoration works conducted in response to the April 2015 storms.

control period.<sup>8</sup> The substantive proportion of these additional revenues relate to the efficient and prudent redundancy costs that Ausgrid has incurred since our 2015 final decision in reforming its business to meet the operating expenditure (opex) targets set out in that decision. We discuss how we will ensure Ausgrid does not earn revenues above that allowed in this decision in sections 2 and 5.4.1.

We have remade our decision in response to directions from the Australian Competition Tribunal (Tribunal). In January 2015, Ausgrid was seeking \$12,055.4 million in revenue for the 2014-19 regulatory control period, but we approved a revenue allowance of \$8,785.2 million in our April 2015 final decision (or \$3,207.2 million less than what Ausgrid proposed). In response, Ausgrid sought limited merits review of our decision by the Tribunal. The Tribunal remitted our decision to us, specifically requiring that we remake our decision in relation to Ausgrid's opex forecast and the rate of return with respect to the trailing average approach, and otherwise vary the distribution determination as set out in our 2015 final decision as we consider appropriate.<sup>9</sup> This remade final decision for Ausgrid brings this long-running 2014-19 revenue determination process to a close.

On 15 August 2018, and following a series of consultations with its stakeholders, Ausgrid submitted a new Proposal to us to resolve all outstanding issues relating to the decision we need to remake.<sup>10</sup> Ausgrid proposed total revenue of \$9,189.9 million (\$, nominal) for the five-year 2014-19 regulatory control period. This amount is \$404.7 million more than what we provided for in our 2015 final decision, after adjusting for data updates over time including the impact of actual consumer price index (CPI) inflation being lower than what was expected, and contrasts against the \$1,290 million at issue (the key elements of our 2015 final decision that were disputed were approximately \$731 million for opex and \$559 million in return on debt). Ausgrid's Proposal is based on:

- our 2015 final decision, including the constituent decisions we made on opex and the rate of return (including the cost of debt)
- the revenue that Ausgrid has recovered thus far for the 2014-19 regulatory control period, up to \$652 million (\$ nominal) above our 2015 final decision (of which \$364 million is to be retained by it)

This document sets out our reasons for accepting Ausgrid's Proposal. We have remade our decision in accordance with the NEL and NER. Among other things, this means we have taken into account the revenue and pricing principles (RPP) and the NEO. We are satisfied our remade final decision is likely to contribute to the achievement of the NEO to the greatest degree. The reasons for our decisions are outlined in section 5.

Our remade final decision has been informed by our analysis and stakeholder engagement and submissions.

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<sup>8</sup> The estimated \$310.9 million (\$ nominal) that is expected to be returned to customers in the 2019-24 regulatory control period is our best estimate at this point in time as we will not know the exact amount until after the 2014-19 regulatory control period ends.

<sup>9</sup> *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACompT 1. On 24 May 2017, the Full Federal Court dismissed our appeal and upheld the Tribunal's decision in relation to opex and cost of debt. It upheld the AER's appeal in relation to gamma.

<sup>10</sup> Ausgrid, *Proposal for the remake of Ausgrid's 2014-19 distribution determination*, 15 August 2018.

Energy Consumers Australia (ECA)<sup>11</sup> and the AER Consumer Challenge Panel (CCP10)<sup>12</sup> made submissions that our remade draft decision is in the long-term interests of Ausgrid's consumers.<sup>13</sup> In addition, the Energy Users Association of Australia (EUAA)<sup>14</sup> and the Public Interest Advocacy Centre (PIAC)<sup>15</sup> support Ausgrid's Proposal. While noting that some consumer groups were disappointed that Ausgrid's Proposal was not as timely as that for other NSW distribution businesses, the general consensus of consumer groups was that Ausgrid's Proposal is in the long-term interests of its consumers.<sup>16</sup>

This remade final decision has been made under novel circumstances as set out in section 5.1.1. The circumstances we find ourselves in heighten the importance of us remaking our decision in a timely manner. Timely decision-making is a tenet of best regulatory practice and, in our view, is a principle that is in the long-term interests of consumers.<sup>17</sup>

## 1.1 Structure of this document

This document is structured as follows:

- Section 2 presents our remade final decision for Ausgrid
- Section 3 presents Ausgrid's Proposal
- Section 4 presents stakeholders' submissions on our remade draft decision
- Section 5 presents the reasons for our remade final decision

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<sup>11</sup> Energy Consumers Australia, *Draft Decision: Ausgrid 2014-19 Electricity Distribution Determination remittal*, 2 January 2019.

<sup>12</sup> Consumer Challenge Panel, *Ausgrid 2014-19 revenue allowance remittal, Draft decision*, 20 December 2018.

<sup>13</sup> AER, *Draft Decision Ausgrid 2014-19 distribution determination*, November 2018.

<sup>14</sup> Energy Users Association of Australia, *Re: Ausgrid – Determination 2014-19 – Remittal*, 14 August 2018.

<sup>15</sup> Public Interest Advocacy Centre, *Ausgrid Remittal Proposal*, 16 August 2018.

<sup>16</sup> Stakeholders' written advice on Ausgrid's Proposal is published on the AER's website. <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/evoenergy-determination-2014-19-remittal/proposal>

<sup>17</sup> Regulatory best practice is also the way in which we have committed to act in undertaking our functions and powers: AER, *Statement of Intent 2017-18*, p. 5.

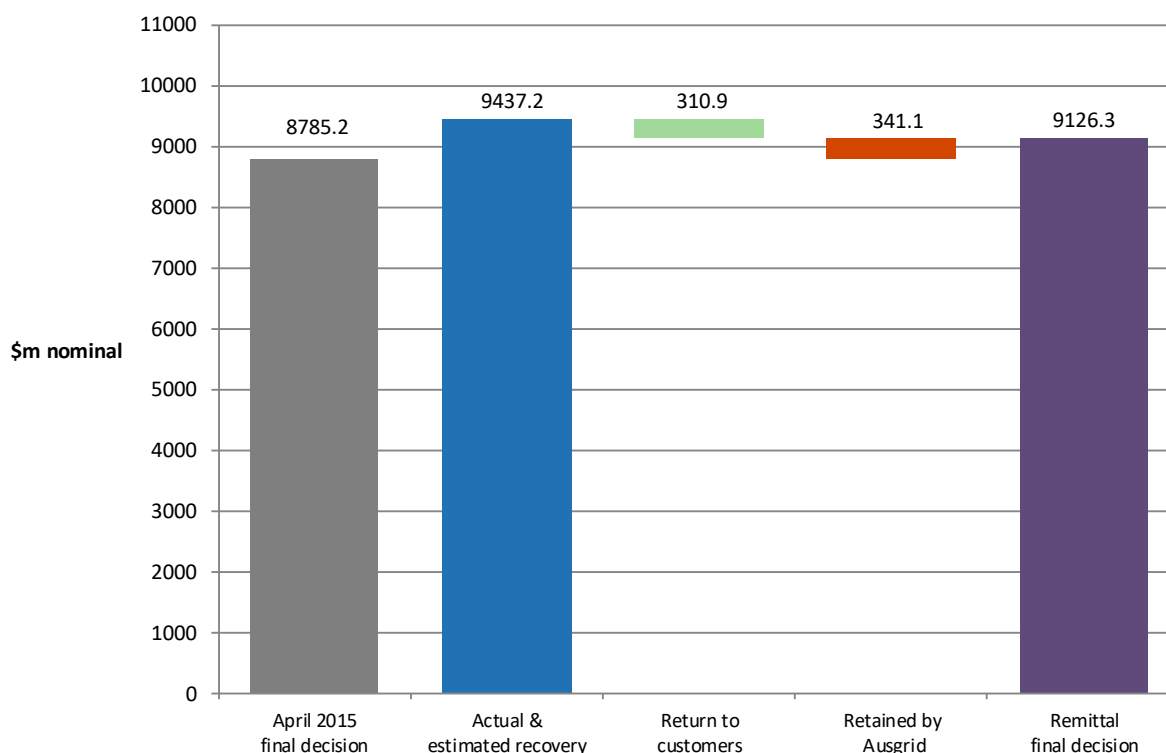
## 2 Our remade final decision

Our remade final decision after remaking the constituent decisions for opex and the rate of return, as well as correcting some other minor aspects relating to our 2015 final decision in accordance with the Tribunal’s directions, is to accept Ausgrid’s Proposal, subject to certain modelling adjustments as set out below.<sup>18</sup>

This means Ausgrid can recover total revenues of \$9,126.3 million (\$ nominal) from consumers over the 2014–19 regulatory control period, as illustrated at Figure 2-1. Our remade final decision is unchanged from our remade draft decision.<sup>19</sup>

The remade final decision is \$341.1 million (\$ nominal) above the revenue allowance we set in our 2015 final decision for Ausgrid. Any additional revenues in excess of this amount, currently estimated at \$310.9 million at 30 June 2019, will be returned to customers in subsequent regulatory years from 2019-20. The estimated \$310.9 million that is expected to be returned to customers in the next (2019-24) regulatory control period is our best estimate at this point in time. We will reconcile to an exact amount once the current regulatory control period completes.

**Figure 2-1 Comparison of AER remade final decision to set aside 2015 final decision for 2014-19 regulatory control period (\$million, nominal)**



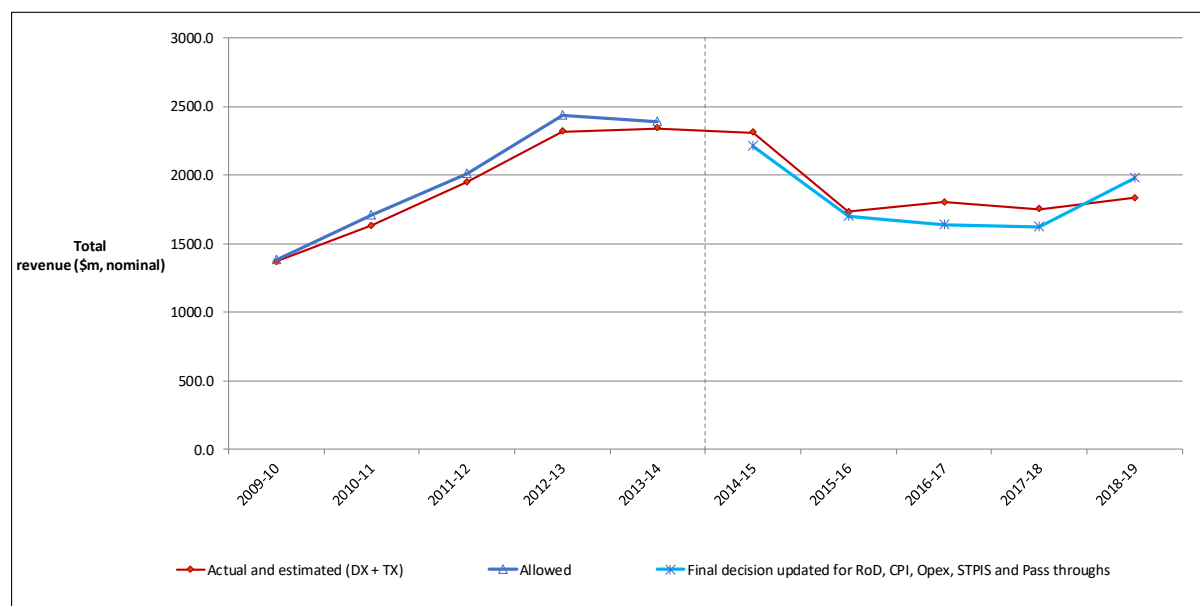
Source: AER analysis.

<sup>18</sup> Ausgrid, *Proposal for the remake of Ausgrid’s 2014-19 distribution determination*, 15 August 2018.

<sup>19</sup> AER, *Draft Decision Ausgrid 2014-19 distribution determination*, November 2018.

We are satisfied that this remade final decision, taking into account the RPP, is likely to contribute to the achievement of the NEO to the greatest degree.<sup>20</sup> Figure 2-2 illustrates our overall decision.

**Figure 2-2 Ausgrid’s past total revenue and AER 2014-19 remade final decision total revenue allowance (\$million, nominal)**



Source: AER analysis.

The network component of customers’ bills were set by our 2015 final decision and following the Tribunal’s decision, by interim pricing measures in 2016–17, 2017–18 and 2018–19.

In the 2014-15 transitional year, distribution network charges reduced, on average, by 1.7 per cent.<sup>21</sup>

In 2015-16, distribution network charges fell significantly, reflecting a reduction in Ausgrid’s real revenues resulting from our 2015 final decision. At the time of our decision, this impact was estimated as a \$165 (8 per cent) reduction in the average bill for a residential customer and a \$264 (8 per cent) reduction in the bill for a small business customer.<sup>22</sup>

During 2016-17 and 2017-18, distribution network charges increased by changes in the CPI, and in 2018-19 are being kept at their 2017-18 levels in nominal terms, in accordance with enforceable undertakings we accepted. The undertakings from Ausgrid addressed pricing uncertainties arising from the limited merits and judicial review processes.

As this remade final decision will lead to an estimated \$310.9 million being returned to consumers in the next (2019-24) regulatory control period, holding everything else constant, we would expect this to put downward pressure on the tariffs faced by Ausgrid’s customers.

<sup>20</sup> NEL, ss. 16(1)(d)(i) and 16(2).

<sup>21</sup> AER, *Transitional Decisions: NSW/ACT 2014-15 Factsheet*, April 2014.

<sup>22</sup> AER, *Final decision Ausgrid distribution determination - Fact Sheet*, April 2015. The analysis assumed distribution network charges made up 38 per cent of customers’ bills on average.



Our remade final decision applies modelling adjustments to the models that support Ausgrid's Proposal.<sup>23</sup> We provided and explained these modelling adjustments to Ausgrid prior to releasing our remade draft decision.<sup>24</sup> In response, Ausgrid acknowledged it had no further issues with the modelling.<sup>25</sup> The net effect on Ausgrid's Proposal is a \$22.9 million reduction in the revenue that Ausgrid will retain under its Proposal (\$9,126.3 million (\$ nominal) instead of \$9,149.2 million<sup>26</sup>) and an increase in the amount that Ausgrid is expected to return to consumers in the next (2019-24) regulatory control period (\$310.9 million (\$ nominal) instead of \$288 million at 30 June 2019<sup>27</sup>).

At the same time as releasing this remade final decision, we have also released a separate final adjustment determination for Ausgrid that has relevance to revenues recovered for both 2014–19 and 2019–24 regulatory control periods.<sup>28</sup> This relates to the revenues that Ausgrid earns from the provision of distribution and transmission standard control services.

Under the NER, we are required to make an adjustment determination in order to ensure Ausgrid recovers only the revenue to which it is entitled and should not receive any windfall gains or losses as a result of the appeals process.<sup>29</sup>

As we discuss in section 5.4.1, we have included a distribution variation amount and a transmission variation amount in our final adjustment determination. The estimated \$310.9 million in revenues at 30 June 2019 that Ausgrid will return to customers in the next (2019-24) regulatory control period is the residual net impact across both distribution and transmission of this decision. We will incorporate the distribution and transmission variation amounts in our final decision on the 2019–24 distribution determination for Ausgrid.<sup>30</sup> As the distribution and transmission variation amounts are based on Ausgrid's estimates for the 2014-19 regulatory control period, a true-up will be required in the 2019-24 regulatory control period.

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<sup>23</sup> Ausgrid, *Proposal for the remake of Ausgrid's 2014-19 distribution determination*, 15 August 2018.

<sup>24</sup> AER, *Email – RE: Ausgrid 2014-19 remittal models*, 17 October 2018.

<sup>25</sup> Ausgrid, *Email – Re: Ausgrid remittal timing*, 31 October 2018.

<sup>26</sup> There were differences between Ausgrid's written Proposal and the supporting modelling it provided to the AER. We have adjusted figures (where appropriate) to be consistent with Ausgrid's written Proposal that \$288 million at 30 June 2019 is to be returned to customers in the 2019-24 regulatory control period. See section 2 of our remade draft decision for more detail on the modelling adjustments that we have applied in this remade final decision: AER, *Draft Decision Ausgrid 2014-19 distribution determination*, November 2018.

<sup>27</sup> The estimated \$310.9 million (\$ nominal) at 30 June 2019 that is expected to be returned to customers in the 2019-24 regulatory control period is our best estimate at this point in time as we will not know the exact amount until after the 2014-19 regulatory control period.

<sup>28</sup> AER, *Final decision, Ausgrid adjustment determination*, January 2019.

<sup>29</sup> NER, cl 8A.14.5(d).

<sup>30</sup> NER, cl 8A.14.5(c)(3) and (5). We incorporated this amount in our draft decision on the 2019–24 distribution determination for Ausgrid.

### 3 Ausgrid's Proposal

On 15 August 2018, we received Ausgrid's Proposal for the remaking of its revenue determination for the 2014–19 regulatory control period.<sup>31</sup>

It is a total revenue proposal. That is, it is not directly presented in terms of the building block components as was the case in its initial and revised regulatory proposals which preceded our April 2015 final decision (and the associated constituent decisions).

Ausgrid engaged with consumer groups on a near-final version of its Proposal prior to submitting its finalised Proposal to us.

Key aspects of Ausgrid's Proposal, before our modelling adjustments as set out in section 2, are summarised below:<sup>32</sup>

"...Ausgrid is proposing to retain \$519 million (\$real, FY19) and forgo \$677 million (\$real, FY19) of our estimated \$1,196 million (\$real, FY19) potential revenue recovery. This represents a \$2.85 billion (\$real, FY19) reduction on the revised proposal Ausgrid submitted on 20 January 2015.

In accordance with the undertakings agreed to and supported by key stakeholders and the AER for the FY17 to FY19 period, Ausgrid expects to collect \$807 million (\$real, FY19) above the set aside 2015 Determination. This proposal will result in \$288 million (\$real, FY19) being returned to customers via price reductions over the 5 years from FY20 to FY24.

...We are proposing to retain...\$438 million...(\$real, FY19) in relation to the opex component of the 2014-19 Remittal. This will cover 64% of the \$688 million (\$real, FY19) of costs we've incurred during the process of transforming our business...We are not proposing to recover the residual costs of about \$250 million (\$real, FY19) that we have incurred while shifting to a lower cost base.

...As part of an overall proposal to resolve the remittal Ausgrid is prepared to accept the AER's preferred cost of debt approach as outlined in its 2015 determination. This approach is consistent with the proposals that the other NSW businesses have put forward to consumers and the AER as part of their 2014-19 remittals. Ausgrid submits this in the interests of re-setting relationships with our customers and the AER.

...In addition to our proposed approach to opex and cost of debt outlined above, we are proposing to retain \$81 million (\$real, FY19) as part of an overall proposal to resolve the 2014-19 Remittal. This approach is consistent with the overall proposals that the other NSW businesses have put forward to consumers and the AER as part of their 2014-19 remittals, taking into account the respective opex and costs of debt positions of the businesses.

Hence we are proposing to recover a total of \$519 million (\$real, FY19) to conclude the 2014-19 Remittal process. This will result in \$288 million (\$real, FY19) being returned to customers in the form of lower bills over five years, taking effect from 1 July 2019.

...Ausgrid recognises that the 2014-19 regulatory determination has a long legal history. We consider it to be in the long term interests of customers and the business that this determination is

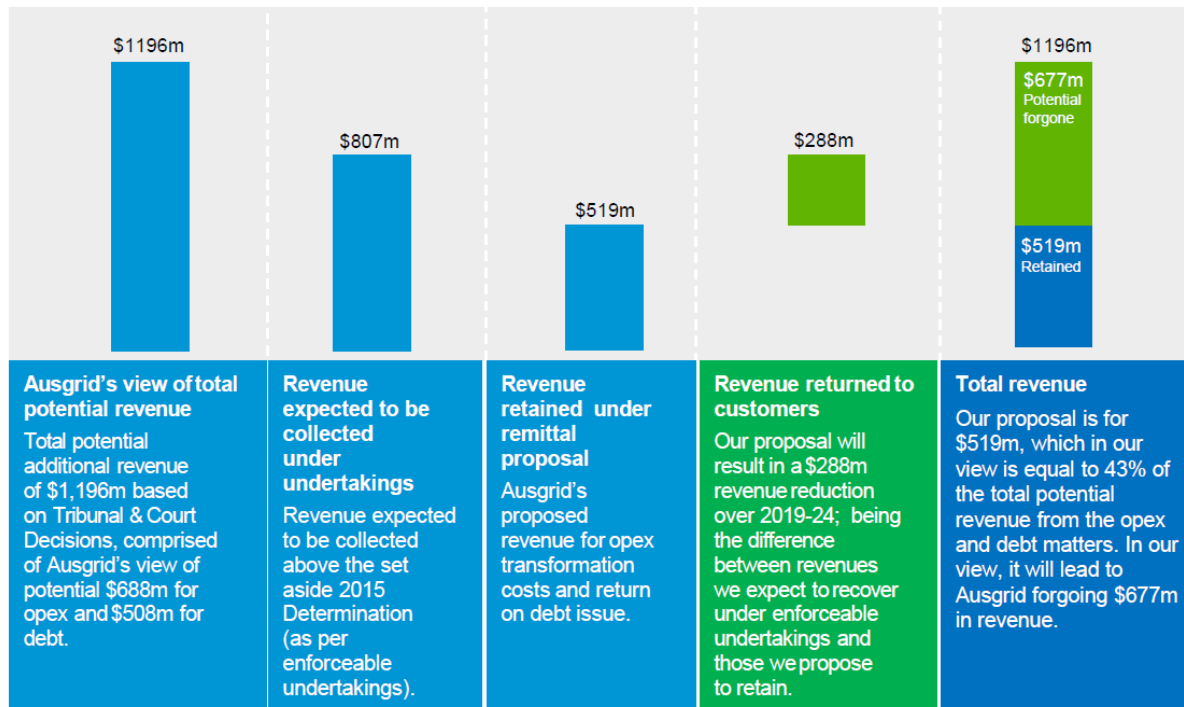
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<sup>31</sup> Ausgrid, *Proposal for the remake of Ausgrid's 2014-19 distribution determination*, 15 August 2018.

<sup>32</sup> Ibid. The graph, "Revenue retained and Ausgrid's view of potential revenue forgone", has been taken from Ausgrid's remittal factsheet which accompanied its remittal Proposal letter.

finalised and consider it an opportunity for Ausgrid and its new management to reset the relationship with the AER, stakeholders and our customers.”

### Revenue retained and Ausgrid’s view of potential revenue forgone



**Ausgrid’s view of total potential revenue**  
 Total potential additional revenue of \$1,196m based on Tribunal & Court Decisions, comprised of Ausgrid’s view of potential \$688m for opex and \$508m for debt.

**Revenue expected to be collected under undertakings**  
 Revenue expected to be collected above the set aside 2015 Determination (as per enforceable undertakings).

**Revenue retained under remittal proposal**  
 Ausgrid’s proposed revenue for opex transformation costs and return on debt issue.

**Revenue returned to customers**  
 Our proposal will result in a \$288m revenue reduction over 2019-24; being the difference between revenues we expect to recover under enforceable undertakings and those we propose to retain.

**Total revenue**  
 Our proposal is for \$519m, which in our view is equal to 43% of the total potential revenue from the opex and debt matters. In our view, it will lead to Ausgrid forgoing \$677m in revenue.

## 4 Stakeholder submissions on our remade draft decision

On 22 November 2018, we released our remade draft decision for Ausgrid for the 2014-19 regulatory control period for public consultation.<sup>33</sup> Our remade draft decision accepted Ausgrid's Proposal, subject to certain modelling adjustments, to recover total revenues of \$9,126.3 million (\$, nominal) from consumers over the five-year 2014-19 regulatory control period. We noted that if our remade draft decision became our final decision for Ausgrid, it would result in a revenue allowance of \$341.1 million (\$ nominal) above the revenue we set in our 2015 final decision. We also noted that an estimated \$310.9 million (\$ nominal) at 30 June 2019 in revenue would be returned to Ausgrid's customer's in the next (2019-24) regulatory control period.

We received two stakeholder submissions on our remade draft decision:<sup>34</sup>

- Energy Consumers Australia (ECA)
- AER Consumer Challenge Panel, Sub-panel 10 (CCP10)

Both stakeholders supported our remade draft decision as being in the long-term interest of Ausgrid's customers. Key points raised in submissions are summarised below.

We also note that our remade draft decision included a summary of supporting comments previously received from stakeholders following Ausgrid's pre-lodgement engagement on its Proposal.<sup>35</sup> Comments were received from ECA, CCP10, the Energy Users Association of Australia (EUAA) and the Public Interest Advocacy Centre (PIAC).

All of the above stakeholders' submissions are available on our website.<sup>36</sup>

### 4.1 Energy Consumers Australia

In its response to our remade draft decision, ECA submitted:<sup>37</sup>

"Consistent with the reasons in our August 2018 letter to Ausgrid, we support the AER's draft decision to accept Ausgrid's proposal, which we understand from the AER is subject to modelling adjustments. This means that:

- Ausgrid can recover total revenues of \$9,126.3 million. This is the total of the AER's original decision of \$8,785.2 million and an additional \$341.1 million; and
- Ausgrid will return an estimated \$310.9 million to consumers. This figure is greater than the \$288 million proposed by Ausgrid.

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<sup>33</sup> AER, *Draft Decision Ausgrid 2014-19 distribution determination*, November 2018.

<sup>34</sup> Ibid.

<sup>35</sup> Refer to our remade draft decision for a summary of stakeholders' comments on Ausgrid's Proposal for the 2014-19 regulatory control period. ECA, EUAA, PIAC and CCP10 considered the proposal to be in the long-term interest of Ausgrid's customers: AER, *Draft Decision Ausgrid 2014-19 distribution determination*, November 2018, pp. 18-21.

<sup>36</sup> <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/ausgrid-determination-2014-19-remittal>

<sup>37</sup> Energy Consumers Australia, *Draft Decision: Ausgrid 2014-19 Electricity Distribution Determination remittal*, 2 January 2019.

We support this decision and acknowledge that, in its draft decision, the AER states that it has discussed the modelling changes with Ausgrid who has no further issues.

As stated in our letter to Ausgrid, it is unfortunate that it has taken so long for this matter to be resolved...

We are currently engaging with Ausgrid on its revised proposal for the 2019-24 regulatory period, and during this time, Ausgrid has demonstrated an improvement in its engagement with us. We look forward to continue to engage with Ausgrid to get better consumer outcomes into the future.”

## 4.2 Consumer Challenge Panel

The AER established the CCP in July 2013 to assist us to make better regulatory determinations by providing input on issues of importance to consumers. The expert members of the CCP bring consumer perspectives to us to better balance the range of views considered as part of our decisions.

In its response to our remade draft decision, CCP10 submitted:<sup>38</sup>

“CCP10 is supportive of the AER’s Draft Decision regarding the remitted 2014-19 revenue decision for Ausgrid...

CCP10 worked closely with Ausgrid and consumer groups observing the process that was undertaken to produce the revised revenue proposal...

The AER’s Draft Decision means that Ausgrid will recover \$9,126.3 million (\$ nominal) over the 2014-19 regulatory control period. This results in a nominal increase of \$341.1 million above the appealed decision by the AER from 2015. This Draft Decision also means that about \$310.9 million (at 30<sup>th</sup> June 2019 estimate), will be returned to customers over the 2019-24 regulatory period...

We note that a significant component of the increase in nominal allowance for the remitted decision compared to the 2015 final decision relates to the impact of the redundancy and other one-off career costs incurred as a result of the NSW Electricity Network Assets (Authorised Transactions) Act 2015 (ENA Act). We accept that these costs were necessary to enable Ausgrid to continue its transformation to a more efficient workforce. CCP agrees that since 2015 Ausgrid has made substantial changes to its underlying cost structure, becoming more efficient and that the one-off costs in achieving this were necessary and prudent. We are further satisfied that consumers will benefit from the efficiency actions both in the forthcoming regulatory period and beyond.

In our view consumers will benefit from:

- the certainty provided by the resolution of the proposed price path
- the removal of the risk for consumers from the reopening of the contentious issues from the Federal Court decision, particularly in regard to debt costs
- on an ongoing basis from the reductions in operating expenditure that Ausgrid has achieved
- the continuation of reduction in network prices into 2019-24 once the ENA Act ceases to apply to Ausgrid and

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<sup>38</sup> Consumer Challenge Panel, *Ausgrid 2014–19 revenue allowance remittal, Draft decision*, 20 December 2018.

- improved consumer engagement processes...

We agree that this unique set of circumstances is highly unlikely to occur again and so this Draft Decision cannot be seen to be creating any precedent for future regulatory process. However, learnings from having significant consumer group involvement at all key stages in exploring and considering solutions has considerable future application...

Whilst we are relieved that the process for the Ausgrid remitted decision for the 2014-19 determinations is now well advanced, CCP10 is disappointed, along with consumer groups that it took Ausgrid 12 months following the AER roundtable to be in this position. One of the key benefits discussed at the roundtable meeting 16 months ago was to achieve an expedited process and a quicker resolution for the remittal...

We commend Ausgrid and its new shareholders for taking the opportunity to finally resolve the 2014-19 revenue determinations. Consumers were not well served by the regulatory impasse between the AER and the NSW/ACT businesses around the 2014-19 determinations. We encourage Ausgrid to continue to develop more transparent and embedded consumer engagement, not just as part of its 2019-24 proposal, but into the future as part of its 'business as usual' business planning."

## 5 Reasons for our remade final decision

Our remade final decision is unchanged from our remade draft decision.<sup>39</sup> Similarly, our reasons for arriving at our final position are unchanged.

### 5.1 Our approach

As is the case with making any distribution determination, there may be several possible overall decisions that we could potentially make that will, or are likely to, contribute to the achievement of the NEO. In these circumstances, the NEL directs us to make the decision that we are satisfied will, or is likely to, contribute to the achievement of the NEO to the greatest degree.<sup>40</sup>

Determining whether any particular decision will, or is likely to, contribute to achieving the NEO is a matter of regulatory judgment which involves assessing the decision as a whole, having regard to stakeholder views, taking into account the RPP and complying with the specific requirements of the NER. Implicit in this task is recognising that a distribution determination is more than just the sum of its constituent decisions or component parts as determined in accordance with Chapter 6 of the NER.

#### 5.1.1 The novel circumstances we face

The approach we have applied in remaking this final decision has necessarily been influenced by the novel circumstances that we face now. These are novel circumstances because they materially differ from those we faced when we made our 2015 final decision, and what we would generally face in making a distribution determination.

Specifically, we are remaking this decision at a time:

- that is more than four years into the applicable five-year 2014-19 regulatory control period
- when we have applied interim pricing measures for the 2016-17, 2017-18 and 2018-19 regulatory years by accepting enforceable undertakings to address pricing uncertainties arising from the limited merits and judicial review processes
- when we have had a number of Tribunal and Federal Court processes, since the Tribunal's decision on Ausgrid, that have considered and clarified the law in relation to 'efficient financing costs' and the determination of the cost of debt, as well as opex redundancy costs
- when we have information on Ausgrid's actual performance for the first three years of the five-year 2014–19 regulatory control period and updated forecasts for the remaining two years

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<sup>39</sup> AER, *Draft Decision Ausgrid 2014-19 distribution determination*, November 2018.

<sup>40</sup> NEL, ss. 16(1)(d)(i) and 16(2).

- when our decision has the potential to create significant retail price fluctuations if it differs materially from our 2015 final decision<sup>41</sup>
- when we have released our draft decision in response to Ausgrid's revenue proposal for the forthcoming (2019-24) regulatory control period
- when there is support from a range of consumer groups that Ausgrid's Proposal is in the long-term interests of consumers

## 5.1.2 Assessing the overall decision

Ultimately, assessing whether this remade final decision achieves the NEO to the greatest degree involves us exercising our judgment to determine whether the overall decision will promote efficiencies in relation to investment, and the operation and use of Ausgrid's network that is in the long-term interests of consumers. This involves us balancing the various, and at times competing, factors referred to in the NEO. We must also take into account the RPP in determining how the NEO may be achieved to the greatest degree.<sup>42</sup>

This is the same approach that we applied in our remade draft decision<sup>43</sup> and 2015 final decision.<sup>44</sup> This approach was also affirmed by the Tribunal in its reasons of 26 February 2016.<sup>45</sup>

In considering whether this remade final decision is likely to contribute to the achievement of the NEO to the greatest degree, in respect of our assessment of Ausgrid's Proposal, we note that there are potentially a range of possible outcomes that may meet the Tribunal's directions.

## 5.2 Assessment of Ausgrid's Proposal

In light of the novel circumstances we are faced with, and the information before us, we are satisfied that accepting Ausgrid's Proposal, subject to certain modelling adjustments as set out in section 2, will result in an outcome that is likely to contribute to the achievement of the NEO to the greatest degree.

Key reasons for our decision to accept Ausgrid's Proposal, subject to certain modelling adjustments, are outlined below.

First, remaking the opex and cost of debt constituent decisions reveals a result that is unchanged from our remade draft decision and consistent with revenues that we arrived at in our 2015 final decision with allowance for some additional efficient costs Ausgrid has

<sup>41</sup> Recognising that this prospect is to some extent alleviated by the rule made by the AEMC on 1 August 2017 that allows us to let Ausgrid recover any additional revenues that result from our decision across both 2014–19 and 2019–24 regulatory control periods. See AEMC, AEMC, *Rule determination: National Electricity Amendment (Participant derogation - NSW DNSPs revenue smoothing) Rule 2017, 1 August 2017*; AEMC, *National Electricity Amendment (Participant derogation - NSW DNSPs Revenue Smoothing) Rule 2017 No. 6*, commencing 15 August 2017.

<sup>42</sup> See NEL, s. 16(2). As affirmed by the Federal Court in *Australian Energy Regulator v Australian Competition Tribunal (No 2)* [2017] FCAFC 79, [36].

<sup>43</sup> AER, *Draft Decision Ausgrid 2014-19 distribution determination*, November 2018.

<sup>44</sup> AER, *Final decision, Ausgrid distribution determination 2015–16 to 2018–19, Overview*, April 2015, pp. 52-53.

<sup>45</sup> *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACompT1, [77].



incurred above this level. This is discussed in sections 5.3.1 and 5.3.2, respectively. This result aligns with Ausgrid's Proposal that is, in part, premised on the revenue forecast set in our 2015 final decision.

Second, the novel circumstances we find ourselves in heightens the importance of us remaking our decision in a timely manner. Timely decision-making is a tenet of best regulatory practice and, in our view, is a principle that is in the long-term interests of consumers.<sup>46</sup> Resolving the uncertainty created by the limited merits and judicial review processes in a timely manner, by expediting this remittal process where possible compared to an extended timeframe of potentially up to 18 months for a regular determination process, is supported by several consumer groups and Ausgrid (particularly in light of its 2019-24 regulatory proposal which is currently under review).<sup>47</sup> We note that some consumer groups were disappointed that Ausgrid's Proposal was not as timely as that for other NSW distribution businesses.<sup>48</sup> This remade final decision resolves resolve this uncertainty and addresses the crucial issue of price stability, which informs consumers of their budgetary and investment decisions on the use of electricity services. Price stability, or minimising price volatility, is also in the long-term interests of consumers and is one of the primary reasons we accepted the enforceable undertakings that Ausgrid gave to us to govern prices for the 2016–17, 2017–18 and 2018–19 regulatory years.<sup>49</sup>

Third, we consider that Ausgrid's revenue Proposal represents an efficient level of expenditure necessary for it to provide safe and reliable electricity services to its consumers. As we discussed in section 5.1.2, the approach we have applied in this remade final decision involves us exercising our judgment to determine whether the overall decision will promote efficiencies in relation to investment, and the operation and use of Ausgrid's network that is in the long-term interests of consumers. In other words, the long-term interests of consumers are served by us identifying how the level of electricity supply services delivered by Ausgrid so far during the 2014-19 regulatory control period may be done at least cost to the consumer.

The following observations are relevant. Ausgrid's Proposal, as accepted in this remade final decision with the inclusion of certain modelling adjustments, is:

- \$2,929.1 million (\$ nominal) less than its January 2015 revised regulatory proposal
- represents a reduction in its opex of around \$342.3 million (\$2013–14), or approximately 13 per cent, relative to its January 2015 revised regulatory proposal

We also note that Ausgrid has made the commitment that its recurrent opex for 2017-18 (i.e. its actual opex less non-recurrent transformation costs) will be consistent with our 2015 final

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<sup>46</sup> Regulatory best practice is also the way in which we have committed to act in undertaking our functions and powers: AER, *Statement of Intent 2017-18*, p. 5.

<sup>47</sup> For example, several participants expressed support to expedite this remittal process at the NSW and ACT remittal roundtable we held on 16 August 2017: AER, *NSW and ACT remittal roundtable summary note*, p. 4. Also, sections 4 of the remade draft and final decisions summarise the views of consumer groups on Ausgrid's Proposal and they expressed similar views.

<sup>48</sup> See stakeholder submissions summarised in section 4 of this remade final decision, and section 4 of the remade draft decision: AER, *Draft Decision Ausgrid 2014-19 distribution determination*, November 2018.

<sup>49</sup> See AER, *Open letter to stakeholders: Electricity network charges in the ACT and NSW from 1 July 2017*, 19 April 2017; and *Open letter to stakeholders: Electricity network charges in the ACT and NSW from 1 July 2018*, 21 March 2018.

decision, and this level of opex will form the base year for its opex forecast for the 2019-24 regulatory control period.<sup>50</sup>

In coming to a revenue settlement allowance of \$81 million (\$ nominal) as at 30 June 2019 above our remade opex and cost of debt constituent decisions, which we also note is supported by consumer groups as summarised below, we have considered the following factors:

- It represents an outcome that quantifies and appropriately balances the risk and uncertainty of a protracted decision process faced by affected stakeholders, including consumers. This is in the context where stakeholders have stated a clear preference for us to remake the decision in a timely manner and to resolve uncertainty in light of the circumstances described above.
- It provides greater certainty and price stability for customers for the remainder of this and over the next regulatory period.

We have given weight to the expressions of support from the ECA, CCP10, EUAA and PIAC in respect of our remade draft decision and Ausgrid's Proposal. Notably, given the circumstances, each of these stakeholders considers that this revenue allowance results in an outcome that is in the long-term interests of Ausgrid's customers.<sup>51</sup>

The implications for our control mechanism constituent decisions for the 2014-19 and 2019-24 regulatory control periods are discussed in section 5.4.1.

### 5.3 Remaking the operating expenditure and return on debt constituent decisions

The Tribunal's directions that we are to comply with in remaking our decision for Ausgrid are as follows:<sup>52</sup>

- “(a) the AER is to make the constituent decision on opex under r 6.12.1(4) of the National Electricity Rules in accordance with these reasons for decision including assessing whether the forecast opex proposed by the applicant reasonably reflects each of the operating expenditure criteria in r 6.5.6(c) of the National Electricity Rules including using a broader range of modelling, and benchmarking against Australian businesses, and including a 'bottom up' review of Ausgrid's forecast operating expenditure;

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<sup>50</sup> Ausgrid, *Ausgrid's Regulatory Proposal 1 July 2019 to 30 June 2024*, April 2018, pp.131–132.

<sup>51</sup> Energy Consumers Australia, *Draft Decision: Ausgrid 2014-19 Electricity Distribution Determination remittal*, 2 January 2019; Energy Consumers Australia, *Proposal for the remake of Ausgrid's 2014-19 Determination*, 10 August 2018; Consumer Challenge Panel, *Ausgrid 2014–19 revenue allowance remittal, Draft decision*, 20 December 2018; Consumer Challenge Panel, *Ausgrid 2014–19 revenue allowance remittal proposal*, 15 August 2018; Energy Users Association of Australia, *Re: Ausgrid - Determination 2014-19 – Remittal*, 14 August 2018; Public Interest Advocacy Centre, *Ausgrid Remittal Proposal*, 16 August 2018.

<sup>52</sup> Applications by Public Interest Advocacy Centre Ltd and Ausgrid [2016] ACompT1. Note direction (c) is omitted following the Court's decision in relation to gamma: *Australian Energy Regulator v Australian Competition Tribunal (No 3)* [2017] FCAFC 80, [738]-[784].

- (b) the AER is to make the constituent decision on return on debt in relation to the introduction of the trailing average approach in accordance with these reasons for decision;

...

- (d) the AER is to consider, and to the extent to which it considers appropriate to vary the Final Decision in such other respects as the AER considers appropriate having regard to s 16(1)(d) of the National Electricity Law in the light of such variations as are made to the Final Decision by reason of (a)-(c) hereof.”

The rules in the NER and provisions in the NEL that govern our assessment of opex and debt remain unchanged on remittal.

In the following sections, we set out our remade constituent decisions for opex and the cost of debt, as well as the implications for our control mechanism constituent decisions for the 2014-19 and 2019-24 regulatory control periods.<sup>53</sup>

### 5.3.1 Operating expenditure constituent decision

In this remade final decision, our remade operating expenditure (opex) constituent decision has not changed from our remade draft decision.<sup>54</sup>

Opex refers to operating, maintenance and other non-capital expenses. Forecast opex for prescribed distribution services is one of the building blocks that typically make up a service provider’s total revenue requirement.

In making our 2015 final decision, we found that the actual opex incurred by Ausgrid in its proposed base year of 2012–13 was materially greater than what a prudent and efficient network service provider would incur in delivering safe and reliable network services to customers.<sup>55</sup> As a result, Ausgrid’s actual opex for this year could not be used as a basis to forecast opex for the 2014-19 regulatory control period.

Consistent with the NER, we estimated a base year of opex for Ausgrid and an alternative opex forecast.<sup>56</sup> We relied on one of our economic benchmarking models (the Cobb Douglas Stochastic Frontier Analysis (SFA) Model) to estimate our substitute base opex amount. We also noted that, based on the information available to us at the time, any costs incurred by Ausgrid in transitioning from its higher level of opex to a lower level consistent with our 2015 final decision could not be included as part of an opex forecast that reasonably reflected the opex criteria.<sup>57</sup>

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<sup>53</sup> At the same time as releasing this remade final decision, we have released a separate final adjustment determination for Ausgrid that has relevance to both 2014-19 and 2019-24 regulatory control periods. See AER, *Final decision, Ausgrid adjustment determination*, January 2019.

<sup>54</sup> See section 5.3.1 of: AER, *Draft Decision Ausgrid 2014-19 distribution determination*, November 2018.

<sup>55</sup> *Ibid.* pp. 7-9.

<sup>56</sup> NER, cll. 6.5.6(d) and 6.12.1(4)(ii).

<sup>57</sup> AER, *Final Decision, Ausgrid distribution determination 2015–16 to 2018–19, Attachment 7 – Operating expenditure*, April 2015, pp. 7-40–7-46.

The Tribunal found that our decision to reject Ausgrid’s opex forecast was not in error.<sup>58</sup> However, the Tribunal determined that we erred in the emphasis we placed on the Cobb Douglas SFA benchmarking model in arriving at our substitute estimate. This decision was subsequently upheld by the Federal Court.

As the Tribunal refers to in its directions, we must remake our opex decision under clause 6.12.1(4) of the NER. This means we must either accept a distributor’s proposed opex forecast, or reject it and determine our own substitute estimate. Clause 6.5.6 of the NER sets out the opex objectives, opex criteria and opex factors that we must consider when making our constituent decision on opex. In summary, we must identify a level of forecast opex that is efficient and prudent and at a level that meets or manages expected demand and sustainably maintains the quality, reliability and security of supply and the safety, reliability and security of the network.

Our assessment has been informed by the Tribunal’s directions to us, and the new and updated information available to us since our 2015 final decision (in particular, Ausgrid’s actual and estimated opex for the current regulatory period). We have also been informed by our extensive consultation with Ausgrid and consumer representatives.

In this context, and considering all the information available to us, our remade opex forecast consists of two components:

- an estimate of a prudent and efficient level of recurrent (or underlying) opex<sup>59</sup> that Ausgrid would need for the safe and reliable provision of electricity services<sup>60</sup>
- an estimate of any non-recurrent costs (including transition costs)<sup>61</sup> above this level of underlying opex that can be considered efficient and prudent costs consistent with the opex criteria<sup>62</sup>

For the reasons set out in this section, we are satisfied that Ausgrid’s proposed opex forecast is consistent with the opex criteria. Table 5-1 sets out this opex forecast.

Further information on our analytical approach and the data we used to inform our analysis is outlined in our remade draft decision.<sup>63</sup> We note that submissions received in response to that decision did not raise any new issues or provide any additional information that necessitates a change to our opex decision as outlined in the remade draft decision.

**Table 5-1 AER 2014-19 remade final decision opex forecast (\$million, 2013–14)**

	2014–15	2015–16	2016–17	2017–18	2018–19	Total
Total opex forecast	507.5	491.9	505.8	428.2	403.6	2337.1

<sup>58</sup> Applications by Public Interest Advocacy Centre Ltd and Ausgrid [2016] ACompT1.

<sup>59</sup> Underlying opex excludes non-recurrent costs including transformation costs.

<sup>60</sup> See section 5.3.1.1 of: AER, *Draft Decision Ausgrid 2014-19 distribution determination*, November 2018.

<sup>61</sup> In line with our 2015 final decision and the Tribunal and Federal Court decisions, we will use the term ‘transition costs’ to describe restructuring costs incurred in transitioning from a higher level of opex to a lower level of opex.

<sup>62</sup> See section 5.3.1.2 of: AER, *Draft Decision Ausgrid 2014-19 distribution determination*, November 2018.

<sup>63</sup> See section 5.3.1 of: AER, *Draft Decision Ausgrid 2014-19 distribution determination*, November 2018.

### 5.3.1.1 Reasons for our decision

#### Our assessment of efficient recurrent opex for 2014-19

This section provides our view on the prudent and efficient level of recurrent opex that Ausgrid would need for the safe and reliable provision of electricity services over the 2014-19 period. In reaching our view, we have primarily relied on Ausgrid's actual costs over the first three years of the 2014-19 regulatory control period and its opex estimates for the last two years. This information was not available to us at the time of our April 2015 decision or the Tribunal and Federal Court decisions. Specifically, we examined changes in Ausgrid's actual and forecast opex between 2012–13 and 2018–19, and considered the extent to which its opex efficiency has increased or decreased relative to its 2012–13 level.<sup>64</sup>

The revealed data shows that after 2012–13, Ausgrid's opex increased and peaked in 2014-15 (the first year of the current period). It then declined in each subsequent year, such that by 2018-19 (the last year of the current period), Ausgrid's opex is forecast to be significantly below its 2012-13 opex and at a level consistent with our 2015 final decision (see Figure 5-1).

Ausgrid states that it will be able to sustain this 2018–19 level of opex over the 2019–24 regulatory control period. To this end, it had proposed its 2017–18 opex excluding transition costs (a level of opex that is consistent with its 2018–19 target opex) as the base year for its 2019-24 revenue forecast.<sup>65</sup>

Ausgrid appears to have responded to the strong incentives imposed by our regulatory regime, including the use of economic benchmarking, to reduce its opex over the current regulatory period.

Having regard to the Tribunal's directions, we have cross-checked the above finding using two supplementary tools to test the efficiency of Ausgrid's 2018–19 opex target. These are:

- Benchmark modelling of Ausgrid's opex forecasts for 2017–18 and 2018–19 with, and without, transition costs. This shows that Ausgrid's 2018–19 opex target represents a significant improvement in opex productivity relative to its 2012–13 level, and relative to that of the other electricity networks' productivity levels as measured in 2016.
- Category level cost analysis that examines the underlying drivers of Ausgrid's opex since 2012–13. The analysis shows that around two-thirds of the opex incurred in the current period above Ausgrid's 2018–19 opex target is attributable to transition costs. The remainder is due to higher levels of maintenance, emergency management and overhead costs in 2014–15 and 2015–16. The decrease in Ausgrid's 2018-19 opex target level is being achieved through significant and sustained cost reductions in maintenance, emergency management and overheads opex, and subsequent decreases in transition costs.

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<sup>64</sup> In April 2015, we found that Ausgrid's 2012–13 opex (proposed as its base year for the 2014–19 period) was materially inefficient and this decision was upheld by the Tribunal in its 2016 decision.

<sup>65</sup> Ausgrid, *Ausgrid's Regulatory Proposal 1 July 2019 to 30 June 2024*, p.130.

Taken together, the results of the revealed and forecast costs, benchmarking, and category analyses indicate that Ausgrid's 2018–19 opex target reasonably reflects an efficient and sustainable level of opex consistent with the opex criteria.

Further information on our analytical approach and the data we used to inform our analysis is outlined in our remade draft decision.<sup>66</sup>

### **Our assessment of efficient non-recurrent costs for 2014-19**

In remaking our opex decision, we must also consider what costs, if any, above the level of recurrent opex we have estimated in the previous section can be considered efficient and prudent costs consistent with the opex criteria, and so can be included in our opex forecast.

Ausgrid has submitted that it be allowed to recover the 'efficient and prudent' transition costs that it has incurred from 2014–15 to 2017–18 under the transformation program undertaken to downsize its operations in line with our 2015 final decision opex forecast.<sup>67</sup> Ausgrid argues that it has had to incur these transition costs to comply with 'legal obligations' under its workplace agreements and the Electricity Network Assets (Authorised Transactions) Act 2015 (NSW) (ENAAAT Act).<sup>68, 69</sup> Ausgrid estimates it will incur \$344.1 million (\$2013–14) in transition costs over the first four years of the current period.

In this remade final decision, we are satisfied that a forecast opex allowance for the 2014–19 regulatory control period which includes Ausgrid's proposed \$344.1 million (\$2013-14) in transition costs reasonably reflects the opex criteria. In coming to this position, we have taken into account the opex factors and the RPP, the Tribunal's directions and reasons, and the new information about Ausgrid's costs that are now available to us.<sup>70</sup>

We recognise that our position in this remade final decision appears to be a departure from our 2015 final decision. Based on the facts before us at the time of the 2015 final decision, we concluded that providing transition costs (such as the costs of making redundancy payments to reduce labour levels and terminating contracts early) were not necessary for Ausgrid to recover at least its efficient costs and safety and reliability operate its network.<sup>71</sup> However, three intervening events have since occurred:

- first, the Tribunal's direction to reconsider transition costs, the subsequent Full Federal Court case and the merits and judicial review cases concerning SA Power Networks
- second, we now have information on Ausgrid's actual costs for the first three of the five regulatory years of the 2014–19 regulatory control period, as well as information on how the business is managing its transformation program

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<sup>66</sup> See section 5.3.1.1 of: AER, *Draft Decision Ausgrid 2014-19 distribution determination*, November 2018.

<sup>67</sup> Ausgrid email 24 May 2018.

<sup>68</sup> *Ibid.*

<sup>69</sup> The ENAAAT Act commenced on 4 June 2015: ENAAAT Act, s. 2. Schedule 4 of the ENAAAT Act, amongst other things, prohibits forced redundancies and changes to the terms of the operator's EAs between 1 July 2015 and 31 July 2020.

<sup>70</sup> NER, cl 6.5.6(c) and 6.5.6(e); NEL, ss 7A(2)(a) and 7A(3).

<sup>71</sup> AER, Final decision, *Ausgrid distribution determination 2015–16 to 2018–19, Attachment 7 – Operating expenditure*, April 2015, pp. 7-40–7-46.

- third, the NSW ENAAT Act commenced on 5 June 2015, which among other things, prohibits Ausgrid from changing the terms of its EBA (including redundancy terms) until 31 June 2020.

The Tribunal did not accept our position on transition in the 2015 final decision.<sup>72</sup> The Tribunal’s position, which was subsequently upheld by the Full Federal Court, and read in light of the recent merits and judicial review cases concerning SA Power Networks, identified three findings that are now relevant to remaking our opex decision and the consideration of non-recurrent transition costs:

- First, whether a decision (such as agreeing to an enterprise bargaining agreement (EBA or EA)), is an endogenous managerial decision of a distributor, or exogenous and not within the control of the distributor, does not itself determine whether transition costs should be provided to allow a distributor to recover a particular kind of cost. It is simply one consideration that must be taken into account in light of all the available information before us.<sup>73</sup> The Tribunal’s position was subsequently confirmed by the Full Federal Court and the Tribunal again in the merits review case concerning SA Power Networks.<sup>74</sup>
- Second, an EBA agreed to under the *Fair Work Act 2009 (Cth)* is not an instrument that constitutes a “regulatory obligation or requirement” under the NEL. It follows that recovery of wage increases and redundancy payments, solely by complying with the terms of an EBA is not a sufficient reason for those costs to form part of an opex forecast. Recent merits and judicial review cases involving SA Power Networks have confirmed that an EBA, for the reason that it does not materially affect the provision of standard control services, is not a regulatory obligation or requirement under the NEL.<sup>75</sup>
- Third, we note the finding of the Tribunal and the Full Federal Court in the merits and judicial review cases concerning SA Power Networks that compliance with an EBA is not necessary to “maintain the safety of the distribution system through the supply of standard control services” in accordance with clause 6.5.6(a)(2) of the NER.<sup>76</sup>

We must now decide the transition costs issue in light of all the information available to us.<sup>77</sup> Since our 2015 final decision, a range of new and updated information on the actual operation of Ausgrid’s transformation program is available. This includes the types and quantity of transition costs incurred over the first three years of the current period and Ausgrid’s forecasts for these costs for the last two years, as well as information on how Ausgrid has managed voluntary redundancies and stranded labour under its career transition program. Further, we have information on the impact of the 2015 ENAAT Act on Ausgrid’s transformation program and transition costs.

<sup>72</sup> *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACompT1, [494].

<sup>73</sup> *Ibid*, [434] and [436].

<sup>74</sup> *Australian Energy Regulator v Australian Competition Tribunal (No 2)* [2017] FCAFC 79, [370]; *Application by SA Power Networks* [2016] ACompT 11, [541] and [542].

<sup>75</sup> *Application by SA Power Networks* [2016] ACompT 11, [521]-[529]; and *SA Power Networks v Australian Competition Tribunal (No 2)* [2018] FCAFC 3, [385].

<sup>76</sup> *Application by SA Power Networks* [2016] ACompT 11, [545]; and *SA Power Networks v Australian Competition Tribunal (No 2)* [2018] FCAFC 3, [397]-[399].

<sup>77</sup> NER 6.12.1(4)

The approach we have applied in considering transition costs and in remaking this final decision has been influenced by the circumstances that we face now. Ultimately, whether we include transition costs remains a matter for us to determine against the opex criteria, taking into account the RPP and in a way that forms part of an overall decision that we are satisfied will, or is likely to, contribute to the achievement of the NEO to the greatest degree.<sup>78</sup> We have assessed Ausgrid's Proposal against the opex criteria in response to the Tribunal's directions, including the three findings and reasoning identified above, and the information now available to us.

As noted above, Ausgrid's forecast opex in 2018–19 has reached a level that is consistent with the forecast opex allowance made in our 2015 final decision. We have considered whether it was necessary for Ausgrid to incur the kinds of transition costs it incurred to arrive at this level of opex.

Ausgrid submitted that to achieve its 2018–19 opex forecast, it had to incur \$344.1 million (\$2013-14) in transition costs to restructure its operations and downsize its workforce.<sup>79</sup> Ausgrid stated that it had to incur these costs to comply with the legal obligations it faces under its 2012 Enterprise Agreement (EA), the associated Redeployment and Redundancy Policy and Memorandum of Understanding (MOU) on Salary Maintenance, and the ENAAT Act (in effect from 1 June 2015 to 31 July 2020).<sup>80</sup> As the type and level of transition costs it has incurred in reducing its opex have been mandated by these legal obligations, Ausgrid considers these costs are necessary and prudent costs that are consistent with the opex criteria.<sup>81</sup> In support of its proposition, Ausgrid provided us with information on how it has operated its transformation program, including the redundancy, stranded labour and career transition program (CTP) components.<sup>82</sup>

We have compared Ausgrid's operation of its transformation program with the obligations it has cited and our findings support the view that it was necessary for Ausgrid to incur these kinds of transition costs under its employment agreements to arrive at a level of opex in 2018-19 that is consistent with the opex forecast in our 2015 final decision. Nothing before us suggests that Ausgrid would have been able to achieve this level of opex without incurring these kinds of transition costs.

In the context of Ausgrid's actions since our 2015 final decision, the enactment of the ENAAT Act and the Tribunal's direction to us, we consider Ausgrid's transition costs are of a kind, in the circumstances, that can be characterised as costs required by a prudent operator to achieve the opex objectives; or alternatively, as cost inputs that would be reasonably expected to achieve the opex objectives.<sup>83</sup> Our reasons here do not rely on the

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<sup>78</sup> NER, cll 6.5.6(c) and 6.5.6(e); NEL, ss 7, 7A(2)(a), 7A(3) and 16.

<sup>79</sup> Ausgrid email 24 May 2018

<sup>80</sup> Ibid.

<sup>81</sup> Ibid.

<sup>82</sup> See Box 5.1 ('Summary of Ausgrid's implementation of its transformation program') in section 5.3.1.2 of: AER, *Draft Decision Ausgrid 2014-19 distribution determination*, November 2018.

<sup>83</sup> NER, cll 6.5.6(c)(2) and 6.5.6(c)(3). Our reasons here do not rely on the instrument through which these costs have been incurred (i.e. the EA or the associated workplace agreements) being characterised as a regulatory obligation or requirement under the NEL, or the proposition that Ausgrid had to incur these costs to maintain the safety of the



instrument in which these costs have been incurred as being characterised as a regulatory obligation or requirement under the NEL.

At the time of our 2015 final decision, we did not have available to us the Tribunal's direction, information on Ausgrid's revealed costs or details on how the transformation program operated. The ENAAT Act had also not been enacted. The Tribunal directed us to have regard to these costs. We have formed the view that, had Ausgrid not incurred these kinds of transformation costs, it is likely it would not have arrived at the level of opex that it has to date and is forecasting to achieve by 2018–19. It has therefore been necessary for Ausgrid to incur these costs in order for it to arrive at a level of opex consistent with an opex forecast that we are satisfied reasonably reflects the opex criteria. Allowing Ausgrid to recover these kinds of costs is therefore also consistent with providing it with a reasonable opportunity to recover at least the efficient costs it incurs in providing direct control network services.

Having determined that the kind of transition costs that Ausgrid has incurred have been necessary for it to achieve the opex objectives, we now consider whether the quantum of \$344.1 million (\$2013–14) is efficient and that which a prudent operator would incur for the purposes of the opex criteria. This is consistent with CCP10's views.<sup>84</sup>

In examining whether Ausgrid's transformation costs are efficient, we have considered the incentives it has faced in incurring these costs over the current period. In Ausgrid's circumstances over the 2014–19 regulatory control period, we consider it has faced a strong incentive to minimise its transition costs within the confines of its legal obligations. During the 2014–19 regulatory control period so far, Ausgrid has faced uncertainty around its final revenue allowance and the final outcome of the appeals process. Faced with this uncertainty, Ausgrid implemented a reform program to reduce its own costs.

This is consistent with Ausgrid's submission that the uncertainty around the level of costs it would eventually be allowed to recover has incentivised it to achieve the 'quickest' transition to a level of opex it believed would be consistent with our 2015 final decision opex forecast.<sup>85</sup> Ausgrid also states in its Proposal that the level of transition costs it has incurred in reducing its opex to a level consistent with our 2015 final decision were determined by the legislative and regulatory obligations and constraints it has faced.<sup>86</sup>

Consistent with the statements made by the Tribunal, we have had regard to the obligations under Ausgrid's EA that was in place at the time of its transformation program. It is our view that the level of redundancy and stranded labour costs have been determined by Ausgrid's workplace agreements, and that under the constraint of the ENAAT Act, Ausgrid has been unable to amend these agreements to reduce these costs. This supports the view that Ausgrid's transition costs are unlikely to be greater than the level necessary to achieve its targeted opex reductions.

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distribution system through the supply of standard control services.

<sup>84</sup> Consumer Challenge Panel, *CCP10 Response to AER Issues Paper: Remitted decisions for NSW/ACT 2014-19 electricity distribution determinations operating expenditure*, 30 November 2017, p. 4

<sup>85</sup> Ausgrid email, 24 May 2018.

<sup>86</sup> Ausgrid, *Proposal for the remake of Ausgrid's 2014-19 distribution determination*, 15 August 2018, p. 3.

We have also considered what actions Ausgrid has taken to manage its workforce and operational requirements during the transition period to ensure transition costs are unlikely to be greater than the level necessary to achieve its targeted opex reductions.

Ausgrid has provided information on policies and processes it has implemented to minimise unnecessary transition costs as it has downsized its workforce.<sup>87, 88</sup> Ausgrid states that it has taken various steps to ensure its career transition program (CTP) costs were minimised. Based on Ausgrid's actual and forecast CTP costs for the first four years of the current period, this information supports the view that Ausgrid's external CTP costs<sup>89</sup> and internal CTP costs<sup>90</sup> are not inefficient, and what a prudent operator would incur in the circumstances

Further information on our analytical approach and the data we used to inform our analysis is outlined in our remade draft decision.<sup>91</sup>

### 5.3.2 Return on debt constituent decision

In this remade final decision, our remade debt constituent decision has not changed from our remade draft decision.<sup>92</sup>

The allowed rate of return provides a network service provider a return on capital that a benchmark efficient entity would require to finance (through debt and equity) investment in its network.<sup>93</sup> The return on capital building block is calculated as a product of the rate of return and the value of the regulatory asset base (RAB). The rate of return is discussed in this section.

Ausgrid's revenue Proposal has implicitly adopted our return on capital allowance that we set in our 2015 final decision (with minor updates for updated return on debt data). This was based on a transition to a trailing average methodology for calculating the return on debt.

Since our 2015 final decision, having regard to the decisions of the Tribunal and Court, we have revised our general approach to determining the return on debt. We now apply a revenue neutral transition when moving from the on-the-day methodology for estimating the cost of debt to a trailing average methodology. While our approach, and the reasoning to support it, has changed since the 2015 final decision, the revenue outcome of our new approach is approximately the same as in that decision.<sup>94</sup> Ausgrid's Proposal is consistent with our new approach to determining the return on debt.

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<sup>87</sup> Ausgrid email 24 May 2018.

<sup>88</sup> See Table 5-3 ('Ausgrid's career transition program (CTP) costs') and related comments in section 5.3.1.2 of: AER, *Draft Decision Ausgrid 2014-19 distribution determination*, November 2018, pp. 50-53.

<sup>89</sup> Approximately 60 per cent of CTP costs (\$3.0 million, nominal) are for external services engaged to provide support and training services for surplus staff. These costs are for specialist HR services which Ausgrid is unlikely to have in-house.

<sup>90</sup> Approximately 40 per cent of CTP costs (\$1.9 million, nominal) are internal costs that Ausgrid attributes to direct staffing by Ausgrid employees of career transition centres, and an estimate of the costs of providing Ausgrid staff and resources to supervise and operate the CTP program.

<sup>91</sup> See section 5.3.1.1 of: AER, *Draft Decision Ausgrid 2014-19 distribution determination*, November 2018.

<sup>92</sup> See section 5.3.2 of: AER, *Draft Decision Ausgrid 2014-19 distribution determination*, November 2018.

<sup>93</sup> The term 'network service provider' relates to service providers that provide gas and electricity transmission and distribution services.

<sup>94</sup> We note a very small change in revenue occurs due to the use of updated debt yield data (pre 5 June 2018 updates).

The revised rate of return allowance for this remade final decision is set out in Table 5-4. These numbers reflect our 2015 final decision with respect to the return on equity and the gearing ratio and a revenue neutral transition calculated using partially updated debt yield data from the Reserve Bank of Australia (RBA)<sup>95</sup> and fully updated data from Bloomberg. The RBA data has been updated for the pre 5 June 2018 RBA revisions only, due to the unique circumstances described in section 5.3.2.5. They also reflect the debt averaging periods we determined to use in our 2015 final decision.

The RBA data has been updated for the pre 5 June 2018 RBA revisions only. The approach we have applied in remaking this final decision has necessarily been influenced by the novel circumstances that we face now. They are materially different from those that we faced when we made our 2015 final decision and what we would generally face in making a distribution determination. Given the circumstances, the late timing of the 5 June 2018 RBA data update<sup>96</sup>, the good faith in which parties have sought resolution of the remittal, and the broad stakeholder support for Ausgrid's Proposal, on balance, we consider that not applying the most up to date RBA data (as updated on 5 June 2018) to this remade final decision is the outcome that contributes to the NEO to the greatest degree.<sup>97</sup>

**Table 5-4 Ausgrid final decision return on debt and return on capital (\$million, 2013-14) and percentage debt portfolio rate of return<sup>98</sup>**

	2014-15	2015-16	2016-17	2017-18	2018-19	Total
Final decision debt portfolio rate of return	6.51%	6.41%	6.26%	6.10%	5.93%	
Final decision return on debt	545.1	541.0	533.8	525.3	513.6	2658.8
Final decision return on capital	941.3	940.7	937.5	932.6	923.7	4675.9

### 5.3.2.1 The NER requirements

We must determine a rate of return such that it achieves the allowed rate of return objective (ARORO).<sup>99</sup> The ARORO is that the rate of return is to be commensurate with the efficient financing costs of a benchmark efficient entity with a similar degree of risk as that which applies to the service provider in respect of its regulated services (its standard control

<sup>95</sup> Reserve Bank of Australia, Letter to AER, *Revisions to statistical table F3*, 4 July 2018.

<sup>96</sup> Ibid.

<sup>97</sup> See section 5.3.2.5 of: AER, *Draft Decision Ausgrid 2014-19 distribution determination*, November 2018.

<sup>98</sup> These numbers reflect the final decision including annual debt updates using data prior to the 5 June 2018 RBA update.

<sup>99</sup> NER ss. 6.5.2(b), 6A.6.2(b).

service in the case of electricity distributors).<sup>100</sup> Therefore, each remade debt decision must contribute to achieving the ARORO.

Other legislative requirements relevant to remaking our debt decision include the NEO, the RPP and any interrelationships with other related components of a distribution determination.<sup>101, 102, 103</sup>

### 5.3.2.2 The Tribunal's decision

On 26 February 2016, the Tribunal handed down its decisions.<sup>104</sup> The Tribunal instructed us to remake the constituent decision on the return on debt in relation to the introduction of the trailing average in accordance with the Tribunal's reasons for its decisions without giving a clear clarification of the directions for the remittal.<sup>105</sup> The Tribunal found us in error in our definition of a benchmark efficient entity as a "regulated" entity. The Tribunal also found us in error in our construction of NER rule 6.5.2(k)(4), based on the information available to the Tribunal at that time.

### 5.3.2.3 Judicial Review

On 24 March 2016, we applied to the Federal Court for judicial review of the Tribunal's decisions. On 24 May 2017, the Court dismissed our appeals on the return on debt and opex and upheld the Tribunal's decisions in relation to these issues. It upheld the AER's appeal in relation to the value of imputation credits (gamma).<sup>106</sup>

We have carefully considered the full reasoning of the Court in considering what to do to achieve the ARORO, NEO and RPP in this decision. Of relevance, in relation to the Court's decision:

- the Court clarified that a benchmark efficient entity is not necessarily either regulated or unregulated
- the important characteristic of a benchmark efficient entity is that it has a similar degree of risk to the service provider with respect to the provision of its regulated services
- a change in debt estimation methodology does not necessarily result in any impacts for a benchmark efficient entity

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<sup>100</sup> NER ss. 6.5.2(c), 6A.6.2(c).

<sup>101</sup> NEL, ss. 7 and 16(1)(d).

<sup>102</sup> The RPP that are directly relevant to remaking our debt decision are set out at NEL, ss. 7A(2), 7A(3), 7A(5), 7A(6) and 16(2).

<sup>103</sup> NEL, s. 16(1)(c).

<sup>104</sup> *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACompT1; *Applications by Public Interest Advocacy Centre Ltd and Endeavour Energy* [2016] ACompT2; *Applications by Public Interest Advocacy Centre Ltd and Endeavour Energy* [2016] ACompT3; *Application by ActewAGL Distribution* [2016] ACompT4.

<sup>105</sup> *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACompT1, direction 1(b); *Applications by Public Interest Advocacy Centre Ltd and Endeavour Energy* [2016] ACompT2, direction 1(b); *Applications by Public Interest Advocacy Centre Ltd and Endeavour Energy* [2016] ACompT3, direction 1(b); *Application by ActewAGL Distribution* [2016] ACompT4, direction 1(b); *Application by Jemena Gas Networks (NSW) Ltd* [2016] ACompT5, direction 1(a).

<sup>106</sup> *Australian Energy Regulator v Australian Competition Tribunal (No 3)* [2017] FCAFC 80.

In relation to both the decisions of the Tribunal and Court, we also make the following observations:

- The decisions of the Tribunal and Court were not focussed on the interpretation of “efficient financing costs” in the ARORO. We consider this to be an important factor.
- Neither decision removes the requirement to apply a debt methodology that we consider will achieve the relevant legislative objectives for each of the respective service providers affected by the remittals.
- Neither decision requires the use of a trailing average methodology for determining the cost of debt in this remittal.

In subsequent decisions involving other parties, the Tribunal and Full Federal Court have made various findings and comments which are also relevant to these matters. In particular, both the Tribunal and Federal Court have made comments about our new approach to estimating the return on debt that help to clarify how the Tribunal’s decision for Ausgrid should be interpreted.<sup>107</sup> This is discussed in more detail below.

#### 5.3.2.4 Other relevant legal processes

Other legal decisions that we have had regard to in our remade final decision are:

- the decision of the Australian Competition Tribunal for SA Power Networks and the subsequent decision of the Full Federal Court on the appeal of this decision<sup>108</sup>
- the decisions of the Australian Competition Tribunal for ActewAGL (Gas) Distribution and Jemena Electricity Networks Ltd<sup>109</sup>

The decisions of the Tribunal for ActewAGL (Gas) Distribution and Jemena Electricity Networks Ltd are particularly important as they are directly concerned with the application of our new approach to estimating the return on debt.

After the Tribunal handed down its decisions for Ausgrid, we reconsidered our approach to debt estimation methodology. The new approach, which we adopted in our decisions for ActewAGL (Gas) Distribution and Jemena Electricity Networks, does not rely upon a conceptualisation of a benchmark efficient entity as a regulated entity. It recognises that different service providers may have a different benchmark efficient entity. The new approach also does not rely on a change in methodology impacting a benchmark efficient entity to justify our revenue neutral transition. Our new approach does not rely upon an assessment of historical financing practices. Instead, it considers the efficient financing costs (being the costs of equity and debt) in a forward looking manner. Our new approach was subject to review by the Tribunal.

The Tribunal upheld our new approach. It explained more clearly how each of the Tribunal’s and Court’s decisions should be read together consistently. It provided clarification for the earlier Tribunal’s decision on the directions of the Tribunal for the remittal that were

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<sup>107</sup> See, for example, *SA Power Networks v Australian Competition Tribunal (No 2)* [2018] FCAFC 3 at [295].

<sup>108</sup> *Application by SA Power Networks* [2016] ACompT 11; *SA Power Networks v Australian Competition Tribunal (No 2)* [2018] FCAFC 3.

<sup>109</sup> *Application by ActewAGL Distribution* [2017] ACompT 2.

previously unclear to us. We consider these decisions support a revenue neutral transition when moving to a trailing average methodology based on our new approach, or the continuance of an on-the-day methodology for determining the cost of debt, to achieve the NEO.

An important aspect of the decisions for ActewAGL (Gas) Distribution and Jemena Electricity Networks Ltd is the consideration in those decisions of the interpretation of the “allowed rate of return objective” (or ARORO) and the meaning of “efficient financing costs”.<sup>110</sup> We consider these decisions support our ex ante interpretation of efficient financing costs. These decisions and our view on them are covered in further detail in our debt Position Paper on our remitted debt decisions.<sup>111</sup>

On 18 January 2018, the Full Federal Court handed down its decision on *SA Power Networks v Australian Competition Tribunal*.<sup>112</sup> This was a review brought by SA Power Networks from a decision of the Tribunal.<sup>113</sup>

The Full Federal Court noted that the Court had not had the benefit of hearing a number of issues in relation to Ausgrid’s review that had been subsequently put to it in *SA Power Networks vs Australian Competition Tribunal*. We consider this Full Federal Court decision also supports our new revenue neutral debt transition approach which we propose to apply in this remitted debt decision.

### 5.3.2.5 Reasons for our decision

For the reasons set out in our debt Position Paper<sup>114</sup> on our remitted debt decisions and in our APA VTS final decision, we consider a revenue neutral transition to a trailing average debt estimation methodology will lead to an allowed rate of return that will achieve the ARORO and contribute to the achievement of the NEO to the greatest degree. This rate of return will both reflect ex ante efficient financing costs and result in an approximately zero NPV investment outcome which is important to achieving efficient investment incentives. A revenue neutral transition will also substantially eliminate any wealth impact on Ausgrid from changing the debt estimation methodology.

We rely on the reasoning in our APA VTS decision in making this final decision for Ausgrid, as set out in Attachment 3 of our APA VTS determination.<sup>115</sup> This includes an explanation of how our approach has changed in response to relevant legal decisions. We also rely on our explanation and reasoning as set out in the debt Position Paper on our remitted debt decisions in making this final decision.<sup>116</sup>

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<sup>110</sup> Ibid.

<sup>111</sup> AER, *Position paper – Remitted debt decisions for NSW/ACT 2014–19 electricity distribution determinations and Jemena Gas Networks 2015-20 (NSW) Access Arrangement*, December 2017.

<sup>112</sup> *SA Power Networks v Australian Competition Tribunal (No 2)* [2018] FCAFC 3.

<sup>113</sup> *Application by SA Power Networks* [2016] ACompT 11.

<sup>114</sup> Ibid.

<sup>115</sup> AER, *Final Decision APA VTS gas access arrangement 2018 to 2022, Attachment 3 - Rate of return*, November 2017. This decision discusses and applies substantively identical provisions for rate of return as those applicable to electricity distribution.

<sup>116</sup> AER, *Position paper – Remitted debt decisions for NSW/ACT 2014–19 electricity distribution determinations and Jemena Gas Networks 2015-20 (NSW) Access Arrangement*, December 2017.

In relation to the timing of the initial debt averaging period (for the commencement of the trailing average), we have used the initial averaging period set out in our 2015 final decision for the introduction of the trailing average. We also have used the debt averaging periods for the later years of the regulatory control period, as set out in our 2015 final decision, because we consider these will lead to a rate of return that achieves the ARORO and contribute to the achievement of the NEO. All averaging periods were chosen in advance of their commencement and we consider their use should result in an ex ante efficient return on debt allowance. We consider choosing averaging periods after the periods have finished (or post commencement) is generally inappropriate due to the potential incentive on various stakeholders to advocate for averaging periods that give particular results.

We also consider our overall approach will lead to an overall allowed rate of return that will achieve the ARORO and contribute to achieving the NEO because:

- the return on equity we determined in our 2015 final decision was upheld on appeal as was the gearing ratio and we consider these values remain appropriate
- our combination of the yield from two debt series we used to estimate the return on debt in the 2015 final decision, a simple average of yields estimated from the Bloomberg and RBA yield curves, was upheld on appeal in the Tribunal and we consider remains appropriate
- we consider the overall allowed rate of return estimated using our return on debt, return on equity and gearing estimates will result in an allowed rate of return that will achieve the ARORO and contribute to achieving the NEO

Our remade return on debt constituent decision has been informed by our examination of submissions received on our debt Position Paper<sup>117</sup> and remade draft decision.<sup>118</sup> Further information on our analytical approach and the data we used to inform our analysis is outlined in our remade draft decision. We note that submissions received in response to that decision did not raise any new issues or any additional information that necessitates a change to our return on debt decision as outlined in the remade draft decision.<sup>119</sup>

## 5.4 Other aspects of the 2015 final decision to be varied

### 5.4.1 Control mechanism

The control mechanisms for standard control services were not a subject of Ausgrid's appeal of our April 2015 final decision.<sup>120</sup> However, this remade final decision has implications for the operation of the control mechanism for standard control services for the 2019–24 regulatory control period.

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<sup>117</sup> Ibid.

<sup>118</sup> See section 5.3.2 of: AER, *Draft Decision Ausgrid 2014-19 distribution determination*, November 2018.

<sup>119</sup> Ibid.

<sup>120</sup> The control mechanism for Ausgrid's standard control services is the revenue cap. However, different revenue cap formulae apply to Ausgrid's distribution standard control services and transmission standard control services. AER, *Final decision: Ausgrid distribution determination 2015-16 to 2018-19: Attachment 14 – Control mechanisms*, April 2015, pp. 19–21.

The Tribunal's directions that we are to comply with in remaking our decision includes:

“(d) the AER is to consider, and to the extent to which it considers appropriate to vary the Final Decision in such other respects as the AER considers appropriate having regard to s 16(1)(d) of the National Electricity Law in the light of such variations as are made to the Final Decision by reason of (a)-(c) hereof.”

This remade final decision is \$341.1 million (\$ nominal) above our 2015 final decision. This \$341.1 million figure comprises both distribution standard control services and transmission standard control services. At present, we estimate \$310.9 million at 30 June 2019 will be returned to consumers in the next (2019-24) regulatory control period. This amount represents the estimated net difference in revenues Ausgrid has recovered over the 2014-19 regulatory control period and those we have now determined it should have recovered across both distribution and transmission standard control services over that period.

In order to effect the additional \$341.1 million (and only that amount) for the 2014-19 regulatory control period, we have made our final decision adjustment determination that accompanies this remade final decision.<sup>121</sup>

We will require a true-up in the 2019-24 regulatory control period to ensure Ausgrid does not recover any additional revenue above the \$341.1 million for the 2014-19 regulatory control period. This is because we will not know what Ausgrid's actual standard control services revenue for the 2014-19 regulatory control period will be until after this regulatory control period expires.<sup>122</sup> We will ensure Ausgrid earns no more than this amount through the design of the control mechanism for standard control services for the 2019-24 regulatory control period. Any amounts recovered above that allowed in this decision will be returned to customers in the 2019-24 regulatory control period and determined as part of Ausgrid's 2019-24 distribution determination.<sup>123</sup>

In our draft decision for Ausgrid's 2019–24 distribution determination, we set out the true-up mechanisms that ensure Ausgrid does not recover any additional revenue above the \$341.1 million for the 2014-19 regulatory control period. These include clarifying notes in the 'unders' and 'overs' accounts that form part of the control mechanisms.<sup>124</sup> We will finalise these true-up mechanisms in our final decision for Ausgrid's 2019–24 distribution determination after considering stakeholder submissions and any other relevant information.<sup>125</sup>

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<sup>121</sup> AER, *Final decision, Ausgrid adjustment determination*, January 2019, pp. 6–7.

<sup>122</sup> The \$310.9 million at 30 June 2019 to be returned by Ausgrid to customers in the 2019-24 regulatory control period is based on estimates, rather than actual revenue.

<sup>123</sup> In performing the true-up, we will have regard to the remade final decision, our final decision adjustment determination, and Ausgrid's out-turn revenues for the 2014-19 regulatory control period (and any other relevant considerations).

<sup>124</sup> AER, *Draft decision: Ausgrid distribution determination 2019 to 2024: Attachment 13: Control mechanisms*, November 2018, pp. 7–17 and 21–24.

<sup>125</sup> Due for publication by 30 April 2019.



## 5.4.2 Inflation error adjustment

In the course of its review of our decisions of the Victorian electricity distributors and ActewAGL's gas decision, the Tribunal identified an error in how inflation was estimated.<sup>126</sup> The Tribunal made note of the error in its decision and left it to the AER to determine how best to address the error.<sup>127</sup> The error affected not only the decisions under that review, but the 2015 final decisions for the NSW and ACT distributors. The error had not been picked up during the review of the 2015 NSW and ACT decisions.

The error results from an incorrect geometric average calculation undertaken on the annual inflation rates; resulting in an incorrect (lower) inflation rate of 2.38 per cent instead of 2.42 per cent. Correcting the error would result in a downward revenue adjustment with a nominal NPV unsmoothed of approximately \$23 million compared to our 2015 final decision.

On 15 December 2017, we notified Ausgrid (and other NSW/ACT distribution businesses) in writing, stating that we were considering whether it is appropriate to correct the affected determinations when remaking our decisions.<sup>128</sup>

Ausgrid stated in letter dated 8 February 2018:<sup>129</sup>

“We acknowledge that there may be benefits in combining the AER's 2014-19 remake determination with the process of correcting the inflation calculation error. Unfortunately, however, it appears that this change cannot be made as part of the remake of the 2014-19 determination, since the inflation calculation error was not part of the Competition Tribunal's decision, nor is it a consequential change arising from the remake of the opex or debt decisions.”

And,

“If there was a change to the 2.38% CPI estimate applied via the 2014-19 remake determination, or through some other means, our view is that it may be appropriate to also take into account the best information available. Specifically, the 2014-19 estimate of inflation was intended to provide the best estimate at the time the AER made its decision. However, we now have the actual out-turn inflation that will be applied to determine CPI-adjusted revenues for each year of the 2014-19 regulatory period and for the roll forward of the regulatory asset base. Ausgrid suggests therefore that if any changes were made to the forecast of inflation, it would be appropriate to take actual CPI data into account.”

Ausgrid estimated outturn inflation at 1.91 per cent and that the impact of this (being 47 basis points) lower than the AER's initial estimate of 2.38 per cent would be to reduce the actual nominal return on capital provided through the regulatory framework by approximately \$330 million compared to the expected return on capital at the start of the regulatory control period. It considers adjusting the inflation figure from 2.38 per cent to 2.42 per cent would

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<sup>126</sup> File Nos: ACT 3, 4, 5, 6, 7, 8 of 2016: <http://www.competitiontribunal.gov.au/current-matters/tribunal-documents>

<sup>127</sup> For example, see ACT, Application by ActewAGL Distribution [2017] ACompT 2, 17 October 2017, p i-iii.

<sup>128</sup> AER, *Proposed correction to an inflation calculation error impacting ActewAGL distribution determination 2014-19*, 15 December 2017.

<sup>129</sup> Ausgrid, *Response to AER correspondence of 15 Dec 2017 – Proposed correction of an inflation calculation error impacting Ausgrid distribution determination 2014-19*, 8 February 2018.

reduce the actual nominal return on capital by a further \$23 million, bringing total under-compensation to \$353 million.

Ausgrid also raised a number of matters it had raised during a review of the regulatory treatment of inflation completed in 2017. We have considered Ausgrid's submissions but we are of the view that the correction to the inflation error should be addressed in our decision. We have therefore used an inflation forecast of 2.42 per cent. This corrects for the mathematical error (as explained in our 15 December 2017 letter to Ausgrid) that resulted from an incorrect geometric average calculation undertaken on the annual inflation rates. Our remade draft decision included our response to Ausgrid's specific arguments as raised in its letter of 8 February 2018.<sup>130</sup>

### 5.4.3 Minor correction to our 2015 final decisions

On 20 May 2015, we published an open letter notifying our intention to correct several errors in our April 2015 final decision once any appeal to that decision is resolved.<sup>131</sup> As per the approach we took in our remade draft decision<sup>132</sup>, and as part of this remade final decision for Ausgrid, we now refer and give effect to that open letter which sets out our proposed correction for the following errors in our 2015 final decision:

1. Inaccurate description of metering in Appendix A to the Overview
2. Inaccurate public lighting prices
3. Parameter missing for control mechanism

To ensure the relevant legal documents accurately reflect our decisions, the correction set out in the open letter shall form part of our remade final decision for Ausgrid's 2014-19 remitted determination and supersede the errors we had identified in our 2015 final decision.

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<sup>130</sup> See section 5.4.2 of AER, *Draft Decision Ausgrid 2014-19 distribution determination*, November 2018.

<sup>131</sup> AER, *AER letter to Ausgrid about correcting errors in distribution determination 2015-16 to 2018-19*, 20 May 2015.

<sup>132</sup> See section 5.4.3 of: AER, *Draft decision Ausgrid 2014-19 distribution determination*, November 2018.