

Final decision: CitiPower (distribution) 2016–20

We have made a final decision for CitiPower, one of five electricity distribution network operators in Victoria. Our final decision allows CitiPower to recover \$1500.3 million (\$nominal) from its customers over five years commencing 1 January 2016.

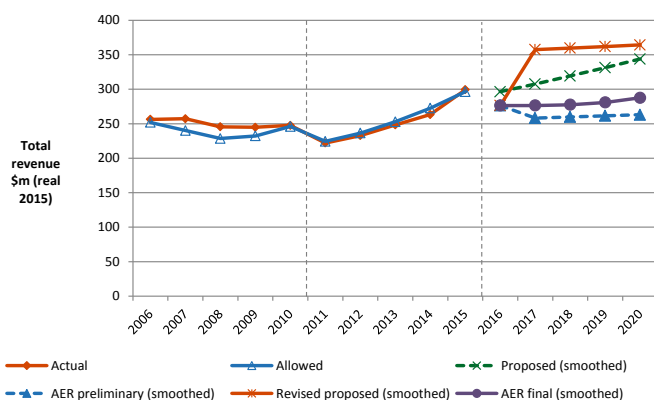
Overview

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

Our final decision allows CitiPower to recover \$1500.3 million (\$nominal) from its customers over five years commencing 1 January 2016. If we had accepted CitiPower's revised proposal, it would have been permitted to recover \$1847.8 million (\$nominal) over the 2016–20 regulatory control period. Our final decision is for 18.8 per cent less revenue than CitiPower's revised proposal.

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

CitiPower's past and proposed total revenue and AER final decision revenue allowance (\$million, 2015)



Note: Revenues relate to standard control services only.

In October 2015, we published our preliminary decision for CitiPower which took effect on 1 January 2016. Our preliminary decision formed the basis for approving prices for the first year of the regulatory control period (2016).

The revenue we determine affects the distribution component of a customer's electricity bill. Distribution charges may make up approximately 20 per cent of the bill for one of CitiPower's typical residential customers.

Other components of customer bills include the cost of generation, transmission, network charges and retailer costs. The AER does not set retail prices.

Estimated impact on customer bills

We estimate the expected bill impact for CitiPower's customers by varying only the distribution and metering charges covered by our final decision. This isolates the effect of our decision on electricity prices, since other components of customer bills (such as wholesale energy generation or retail costs) are not affected by this decision.

We estimate that average annual residential bills for residential customers decreased by \$45 (or –2.9 per cent) in 2016 as a result of our October 2015 preliminary decision. We expect that our final decision will cause annual bills to decrease slightly in 2017 (by \$12 or –0.8 per cent). We then expect that bills will stay almost flat in 2018 (–\$1) and 2019 (+\$2) before increasing slightly in 2020 (+\$6).

For small business customers, we estimate that average annual bills decreased by \$72 (or –2.1 per cent) in 2016. We expect that annual bills will decrease slightly in 2017 (by \$13 or –0.4 per cent) but then stay almost flat in 2018 (+\$2). We also expect slight increases in 2019 (+\$9) and 2020 (+\$19).

These are indicative average impacts only, and individual customers' actual bills will depend on their usage patterns, chosen retail tariff structure, and any changes in costs for other components of electricity bills. You can read more about what makes up the energy prices on customers' bills at: www.aer.gov.au/Consumers

Key elements of our decision

We based our assessment of CitiPower's proposed revenue on a number of components. These include expenditures to maintain and operate the network, and the return to shareholders on their investment. Together, these determine the revenue CitiPower may recover from its customers.

Three components of our final decision drive most of the difference between CitiPower's revised proposed revenue and our final decision: rate of return, operating expenditure (opex) and capital expenditure (capex).

We discuss each of these below.

Rate of return

Significant investment is required to build a distribution network. The return CitiPower must pay lenders and investors is referred to as the rate of return. Even a small difference in the rate of return can have a big impact on revenues.

Our final decision sets the allowed rate of return at 6.11 per cent for 2016. We have not accepted CitiPower’s proposed indicative rate of return of 8.61 per cent for 2016.

The investment environment has improved since our previous decision in 2010, which was made during the period of uncertainty surrounding the global financial crisis. This is reflected in a lower rate of return in this decision. We consider that CitiPower has sought a rate of return that is higher than necessary given the current investment environment.

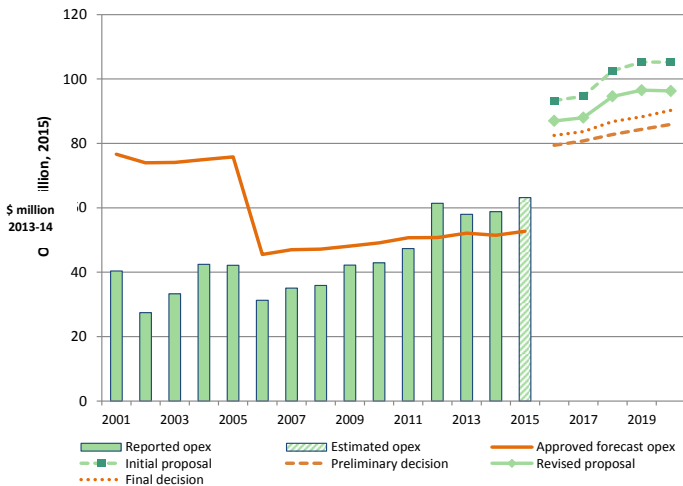
We have not accepted the methodology proposed by CitiPower to set its rate of return. Instead, we have used the methodology we developed through extensive consultation during our Better Regulation program in 2013. We consider that our approach provides for a rate of return that better reflects the allowed rate of return objective.

Operating expenditure

Opex includes forecast operating, maintenance and other non-capital costs incurred in the provision of distribution network services. It includes labour and other non-capital costs that CitiPower is likely to require during the 2016–20 regulatory control period for the efficient operation of its network.

Our final decision allows CitiPower to recover \$431.5 million (\$2015) for opex. This is 7.7 per cent lower than the \$467.3 million CitiPower proposed.

AER final decision compared to CitiPower’s past and proposed opex (\$million, 2015)



The National Electricity Rules require us to be satisfied that the level of opex proposed by CitiPower reflects the opex criteria: the costs that a prudent operator—with efficient costs and a realistic expectation of demand and cost inputs—would need to operate its network safely and comply with its obligations and service standards.

In recent years, we have expanded our regulatory toolkit to make greater use of benchmarking—particularly for opex.

Benchmarking is a way of determining how well a network business is performing against its peers and over time, and provides valuable information on what is ‘best practice’.

Our opex benchmarking results show CitiPower has been operating efficiently compared to other service providers in the National Electricity Market. We therefore have used CitiPower’s revealed (past actual) costs as the starting point for forecasting efficient opex.

We then assess the prudence and efficiency of forecast cost increases going forward. Overall, we consider that CitiPower has proposed more revenue than is required to operate its network prudently and efficiently.

Capital expenditure

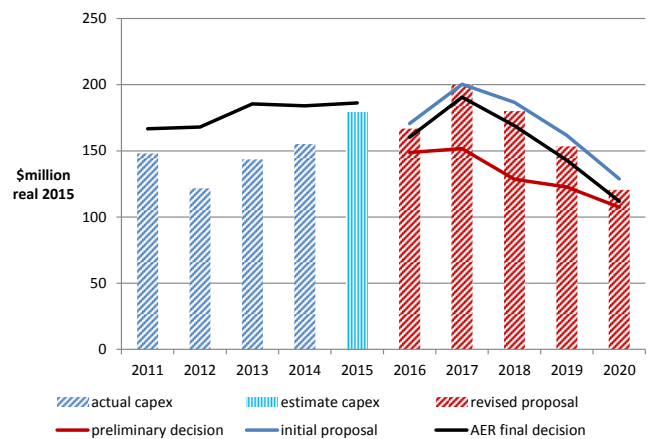
Capex refers to the cost of building new facilities or replacing existing infrastructure. Factors that influence our required level of capex include the age and condition of existing assets.

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

We have estimated total forecast net capex of \$774.8 million (\$2015) for CitiPower’s 2016–20 regulatory control period. This is 5.6 per cent lower than the \$820.9 million CitiPower proposed.

Our capex allowance includes additional expenditure from new safety obligations arising as a result of the recommendations of the 2009 Victorian Bushfire Royal Commission.

AER final decision compared to CitiPower’s past and proposed capex (\$million, 2015)



For more information:

More information on our final decision can be found on our website: www.aer.gov.au.