

Final decision: TransGrid 2018–23

The AER has made its final revenue determination for TransGrid, the electricity transmission network operator in New South Wales and the Australian Capital Territory.

About the AER

The Australian Energy Regulator (AER) works to make all Australian energy consumers better off, now and in the future. This includes:

- regulating electricity networks and covered gas pipelines, in all jurisdictions except Western Australia. We set the amount of revenue that network businesses can recover from customers for using these networks;
- enforcing the laws for the National Electricity Market and spot gas markets in southern and eastern Australia. We monitor and report on the conduct of energy businesses and the effectiveness of competition; and
- protecting the interests of household and small business consumers by enforcing the Retail Law.

The AER drives effective competition where it is feasible and provides effective regulation where it is not.

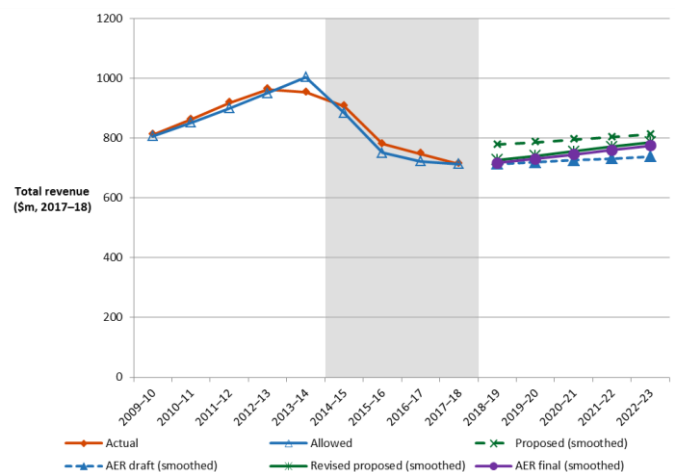
Our work is guided by the National Electricity Objective (NEO) which promotes efficient investment in, and operation and use of, electricity services in the long term interests of consumers. We set network prices so that they reflect efficient costs. Our objective, in only allowing efficient costs, is for energy consumers to pay no more than necessary for the safe and reliable delivery of electricity services.

Our decision

The AER regulates the revenues of transmission businesses, such as TransGrid, by setting the maximum allowed revenue (MAR) it may recover from its customers.

This decision allows TransGrid to recover \$4015.1 million (\$nominal) in the 2018–23 five year regulatory period. This compares to the allowed revenue from the last four year period of \$3036.4 million (\$nominal). On an average annual basis today's decision is \$21.7 million (\$2017–18)—or 2.8 per cent—lower than the AER's 2014–18 decision. It is also a 1.5 per cent reduction from TransGrid's revised proposal for a revenue allowance of \$4074.9 million (\$nominal).

TransGrid's past total revenue, proposed total revenue and our final decision total revenue allowance:



This revenue determination affects the transmission component of a customer's electricity bill. Transmission charges may make up approximately 10 per cent of the bill for typical residential customers in NSW and 4 per cent in the ACT. Other components of customer's bills include the cost of generation, distribution, retailer costs and the cost of environmental policies.

The AER expects that the transmission component of the average annual residential electricity bill will increase, on average and in nominal terms, by \$9 per annum in NSW and \$5 per annum in the ACT over the next 5 years. We estimate that under our final decision the average annual residential electricity bill in 2022–23 would be 2.6 per cent higher in NSW and 1.2 per cent higher in the ACT than the current 2017–18 level (in nominal terms).

Transmission charges are increasing due to the impact of our transitional decision for 2014–15. Under our transitional decision, revenues were 16 per cent higher than under our final decision for 2014–15. We subsequently adjusted the allowed revenue over 2015–18 to allow for the 2014–15 over recovery. Transmission revenues will, however, return to the unadjusted level in the 2018–23 regulatory period.

Rate of return

In this determination we set a rate of return of 6.54 per cent (for 2017–18). This compares to a rate of return of 6.84 per cent in the previous determination (for 2014–15). The rate of return is a forecast of the cost of funds a network business requires to attract investment in the network. In this determination the AER has set the rate of return at 30 basis points lower than its previous determination.

We estimate the rate of return by combining the returns of the two sources of funds for investments—equity and debt. The return on equity is the return shareholders of the business will require for them to continue to invest.

We set a benchmark efficient return on debt allowance based on the prevailing cost of debt observed in capital markets. Since our last determination the observed yields on the bonds that we use to determine the return on debt have fallen. This has led the return on debt falling by 60 basis points.

Capital expenditure

The main point of difference between the AER's decision and TransGrid's proposal is the forecast capital expenditure (capex). Capex refers to TransGrid's investment in new or upgraded assets, such as its lines and transformers, to support the delivery of electricity to its customers.

The AER's forecast of capex is 20 per cent less than TransGrid's proposal for 2018–23, but 12 per cent more than its expected capex for the 2014–18 period.

We accepted TransGrid's move to an enhanced asset and risk management methodology used to better understand the condition and performance of its assets, but found the application resulted in overstated capex.

One aspect of TransGrid's capex proposal that attracted a lot of attention was TransGrid's proposed 'Powering Sydney's Future' project (PSF). The AER did not accept this project in its draft determination but has now accepted PSF in its final decision. Subsequent to our draft determination, TransGrid significantly revised the scope of this project reducing its costs. TransGrid also agreed to establish a supervisory committee with stakeholder representatives which will monitor the project's development to ensure that it benefits consumers.

Our decision also allows flexibility for TransGrid to react to changes in the National Electricity Market. Our decision allows for nine projects to proceed if certain 'contingent' conditions eventuate. The projects are for the connection of large scale renewable generation to the transmission network, including major projects such as Snowy 2.0 and an interconnector between New South Wales and South Australia. When a contingent project is triggered, we then determine the efficient amount of expenditure that meets the capex criteria. In future, we may increase TransGrid's MAR to allow it to recover the cost of these projects should the trigger events occur.
