

Final decision: TransGrid (transmission) 2015–18

We have made a final decision on TransGrid’s transmission determination, TransGrid is the principal electricity transmission network operator in New South Wales and the ACT. Our final decision allows TransGrid to recover \$2188.9 million (\$nominal) over the 2015–18 regulatory control period.ⁱ

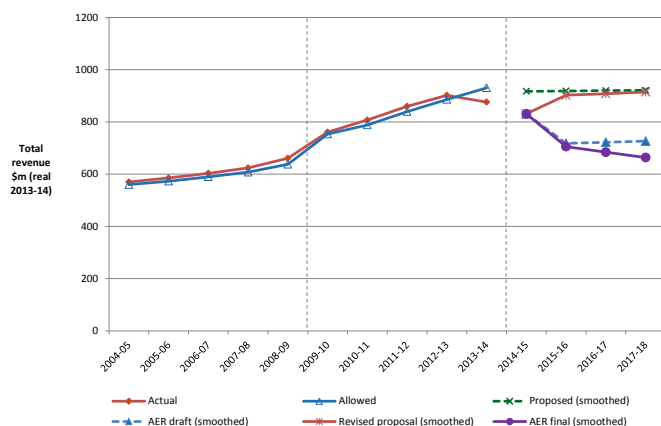
Overview

The Australian Energy Regulator (AER) regulates TransGrid by setting the maximum allowed revenue (MAR) it may recover from customers through transmission network charges.

Our final decision allows TransGrid to recover \$2188.9 million (\$nominal) over the 2015-18 regulatory control period. If we had accepted TransGrid’s proposal, it would have recovered \$2906 million (\$nominal) over the 2015-18 regulatory control period. Our final decision is for 24.7 per cent less revenue than TransGrid’s proposal.

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

TransGrid’s past total revenue, proposed total revenue and AER final decision revenue allowance (\$ million, 2013–14)



The revenue we determine affects the transmission component of a customer’s final bill. Transmission network charges make up about 7 per cent of the bill of a typical residential customer in NSW but for large customers it can be more significant.

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

Estimated bill impact

Based on the lower transmission charges from our final decision passing through to customers, we expect average annual electricity bills for residential customers to reduce by \$22-\$25 (or 1 per cent) in 2015–16 and remain relatively stable over the rest of the period covered by this decision.

For small business customers, we estimate reductions of \$34 to \$41 (or 1 per cent) in 2015-16 and relatively stable bills over the rest of the period covered by this decision.

These are only estimates, and are based on the data we have about how much energy customers in NSW and the ACT use. There are a number of other factors that also affect a customer’s electricity bill, such as the wholesale price of electricity. You can read more about what makes up the energy prices on customers’ bills on our website: <http://www.aer.gov.au/Consumers>.

Key elements of our decision

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

Our final decision on estimates of capital expenditure (capex) and operating expenditure (opex) includes most but not all of TransGrid’s proposed forecast capex and opex. The component of our final decision that has had the greatest impact on the total revenue allowance is rate of return. It is the rate of return that drives most of the revenue gap between us and TransGrid and explains much of why we have approved less revenue for the 2014–18 period than for the 2009–14 period. It also drives most of the difference between TransGrid’s proposal and our final decision.

We discuss each of these below.

Rate of return

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

Our final decision sets the allowed rate of return (or 'cost of capital') at 6.75 per cent for 2015–16. We have not accepted TransGrid's proposal for a rate of return of 8.65 per cent.ⁱⁱ

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

In our final decision we did not accept the methodology proposed by TransGrid to set its rate of return. Instead, we have used our methodology developed with extensive consultation during our Better Regulation program in 2013. We consider that our approach provides for a rate of return that better reflects the allowed rate of return objective.

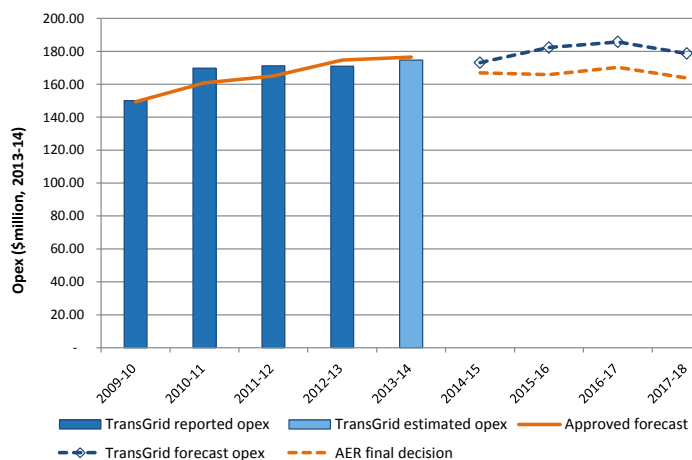
The lower rate of return in this decision will reduce TransGrid's average revenue compared to the past.

Operating expenditure

Opex includes forecast operating, maintenance and other non-capital costs incurred in the provision of transmission network services. It includes labour costs and other non-capital costs that TransGrid is likely to require during the 2014–18 period for the efficient operation of its network.

We have estimated total forecast opex of \$667.0 million (\$2013-14) for TransGrid for the 2014-18 period, excluding debt raising costs. This is 7 per cent less than the \$719.9 million (\$2013-14) TransGrid proposed.

AER final decision compared to TransGrid's past and proposed opex (\$million, 2013-14)



We must be satisfied that the level of opex reflects 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.

Our final decision and TransGrid's proposal use the same 'base year' of actual expenditure as a starting point. However, we have not accepted all the changes in expenditure that TransGrid's proposal suggested were necessary to cover changes in requirements from the current period to the period covered by this decision.

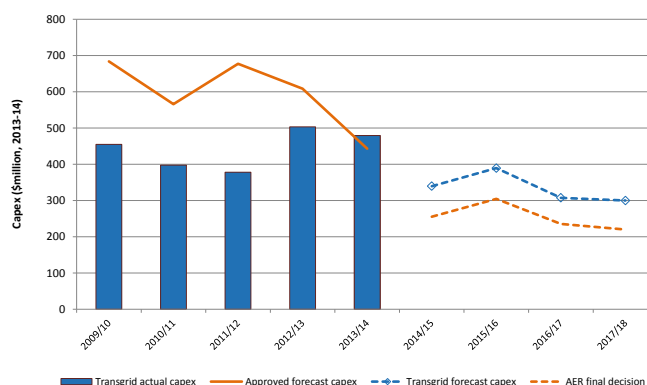
Capital expenditure

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

Capex is another key component of our final decision. We must be satisfied that the level of capex proposed by TransGrid reflects the capex criteria: the costs that a prudent operator—with efficient costs and a realistic expectation of demand and cost inputs—would need to operate its network safely and comply with its obligations and service standards.

We have estimated total forecast capex of \$1015.0 million (\$2013-14) for TransGrid's 2014-18 period. This is 25 per cent lower than the \$1348.1 million (\$2013-14) TransGrid proposed. The key areas of difference between our substitute estimate and TransGrid's revised proposal are that our estimate includes lower expenditure on asset replacement, strategic property acquisitions, and security and compliance-related capex.

AER final decision compared to TransGrid's past and proposed capex (\$million, 2013-14)



For more information:

More information on our final decision can be found on our website: <http://www.aer.gov.au/node/23137>.

ⁱ In November 2012 major changes were introduced to the regulation of transmission service providers under the National Electricity Rules. TransGrid's transmission determination was due to commence on 1 July 2014, and apply for a period of five years. So that the new rules could be applied to this decision, transitional rules required two regulatory control periods: a transitional regulatory control period from 1 July 2014 to 30 June 2015; and a subsequent regulatory control period commencing 1 July 2015. We made a fast-tracked placeholder determination for 2014-15. That determination has been adjusted (or 'trued up') in this final decision. TransGrid's approved revenue for the combined 2014-19 period is \$3034.3 million (\$nominal).

ⁱⁱ The rate of return that TransGrid included in its proposal is an indicative value. Its proposal includes provision for the AER to adjust this value based on updated information that was not available when TransGrid submitted its revised proposal. More information on the rate of return can be found in our Rate of Return Fact Sheet.