AUSTRALIAN ENERGY REGULATOR

Draft decision: Power and Water 2019–24

We have made a draft revenue decision for the Power and Water Corporation, the electricity network operator in the Northern Territory. Our draft decision allows Power and Water to recover $758.8 million ($nominal) from its customers over five years commencing 1 July 2019.

Estimated impact on customer bills

The revenue we determine affects the distribution component of a customer's electricity bill. Distribution charges make up approximately 44 per cent of the bill for typical residential customers in NT.

We estimate that under our draft decision the average annual residential electricity bill in the first year of the 2019–24 period would be 9 per cent lower than the current 2018–19 level (in nominal terms).

In dollar terms, we estimate the overall impact for residential customers is a $102 decrease in the electricity bill over the five year period (in nominal terms). For small business customers, we estimate the overall impact is a $390 decrease in the electricity bill over the five year period (in nominal terms) .

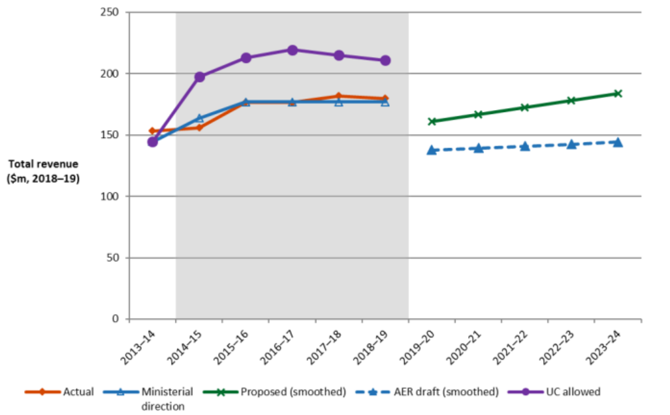
It is important to note the majority of customers in NT are subject to the government's Electricity Pricing Order, which caps retail prices for customers using less than 750MWh of electricity per annum. This prevents price increases but does allow for prices to be set lower than prescribed. However, it is up to retailers (the pre-dominate retailer being the government retailer, Jacana Energy) to determine the price in accordance with the Electricity Pricing Order and pass on to customers any cost savings from lower network revenue determined for Power and Water.

Overview

We, the Australian Energy Regulator (AER), regulate the revenues of Power and Water by setting the total revenue it may recover from its customers.

Our draft decision allows for a decrease in Power and Water's revenue over the 2019–24 financial years (the next period) in real terms. This is represented by a large reduction in revenue in the first year commencing 1 July 2019, followed by gradual increases per annum over the remaining four years.

Power and Water's past and proposed total revenue and AER draft decision revenue allowance ($million, 2018–19)



Our draft decision allows Power and Water to recover $758.8 million ($nominal) in the next period. This is an 18.2 per cent reduction from Power and Water's proposed revenue recovery of $927.9 million ($nominal).

Key elements of our draft decision

We have made a number of adjustments that result in a lower revenue requirement. The key differences between our draft decision and Power and Water's proposal are the return on its investments (rate of return) and the value of imputation credits (gamma), and the forecast capital and operating expenditure (capex and opex). The rate of return is a forecast of the costs of funds a network business requires to invest in its network. Capex refers to Power and Water's investment to acquire or upgrade its fixed assets (such as its lines and transformers). Opex is the forecast operating, maintenance and other non-capital costs incurred in providing network services.

Power and Water will now have the opportunity to respond to our concerns in its revised proposal. We will continue to work with Power and Water and stakeholders to ensure that our final decision is in the long term interests of consumers and that Power and Water's customers are paying no more than they should for safe and reliable electricity.

Rate of return and gamma

The biggest contributor to the difference between our draft decision and Power and Water's proposal is our proposed change to the rate of return (and therefore the return on capital). The rate of return is a forecast of the costs of funds a network business requires to invest in the network. Power and Water's proposal applied a rate of return of 6.62 per cent.

Our draft decision rate of return is 5.22 per cent (nominal vanilla, indicative) for the first year of the 2019–24 regulatory control period. This is a placeholder, subject to change because:

- we estimated our draft decision allowed rate of return using the approach set out in our draft 2018 rate of return guidelines and consultation on this is ongoing, and expected to conclude in December 2018
- there will be updates with more recent data at key milestones throughout this review (Power and Water's revised proposal and our final decision).

The reason for the difference between our allowed rate of return and Power and Water's proposal is we have commenced a 10 year transition to the trailing average for debt in the first year of the 2019–24 regulatory control period, rather than the immediate transition proposed by Power and Water.

Further, our draft decision is to apply a value of imputation credits (gamma) of 0.5 as reflected in our 2018 rate of return guideline draft decision.

Capital expenditure

Power and Water has proposed a 26 per cent increase in net capex from the current period to $383.0 million ($2018–19). Our draft decision capex allowance is $315.6 million ($2018–19).

We have not accepted Power and Water's proposed capex because Power and Water has not justified that its forecast capex represents an efficient level of expenditure that needs to proceed in the next period. We have made reductions to Power and Water's network replacement, network growth and non-network expenditure (e.g. spending on information and technology).

It is important to note that our draft decision is based on information available at the time. The capital expenditure we allow Power and Water could change in our final decision if there is persuasive evidence for a different amount.

Operating expenditure

Power and Water has proposed a 14.2 percent decrease in opex from its total opex in the current period to $339.3 ($2018–19). Our draft decision opex allowance is $305.9 million ($2018–19). This is a reduction of $33.4 million ($2018–19) or 9.8 per cent lower than Power and Water's proposal.

We consider the costs incurred by Power and Water in 2016–17 do not reflect efficient costs. For this reason, we have not used Power and Water's 2016–17 opex as the starting point for forecasting expenditure into the future, even with Power and Water's proposed 10 per cent efficiency factor. We also consider that a majority of Power and Water's step changes for opex are not required and can be largely met by Power and Water's current resourcing and operational efficiencies that have not been reflected in Power and Water's forecasts.

Next steps

Power and Water's revised regulatory proposal is due 29 November 2018. We will assess this proposal and it could lead to significant differences between our draft and final decision.

Stakeholders may make written submissions on our draft decision and Power and Water's revised proposal by 11 January 2019. Our final decision is due for release by the end of April 2019.

More information on Power and Water's proposal, our draft decision and how to make a submission is on our website: www.aer.gov.au.