Preliminary decision:
SA Power Networks (distribution) 2015–20

We have made a preliminary decision for SA Power Networks, the electricity distribution network operator in South Australia. Our preliminary decision allows SA Power Networks to recover $3211.3 million ($nominal) from its customers over five years commencing 1 July 2015.

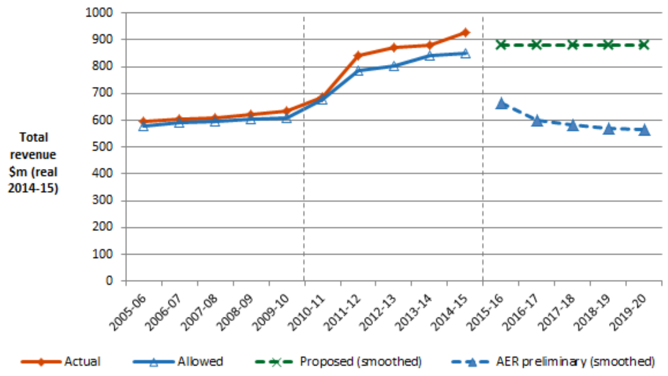
Overview

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

Our preliminary decision allows SA Power Networks to recover $3211.3 million ($nominal) from its customers over five years commencing 1 July 2015. If we had accepted SA Power Networks' proposal, it would have recovered $4744.9 million ($nominal) over the 2015–20 regulatory control period. Our preliminary decision is to accept 32.3 per cent less revenue than SA Power Networks' proposal.

The figure below shows the difference between SA Power Networks' proposed revenue, and what we have allowed in our preliminary decision for each year of the decision.

SA Power Network past and proposed total revenue and AER preliminary decision revenue allowance ($ million, 2014–15)



The revenue we determine affects the distribution component of a customer's electricity bill. Distribution charges make up about 38 per cent of the bill of SA Power Networks' typical residential customers.

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

Estimated bill impact

Based on the lower distribution charges from our preliminary decision being passed through to customers, we expect average annual electricity bills for residential customers to reduce by $197 (or 9.8 per cent) in 2015–16, followed by more stable bills over the rest of the period covered by this decision.

For small business customers, we expect reductions of $381 (or 9.8 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 South Australia 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 SA Power Networks' proposed revenue is based on a number of components. These components include expenditure to maintain and operate the network, and the return to investors on their investment. Together, these determine the revenue SA Power Networks may recover from its customers.

Three components of our preliminary decision drive most of the difference between SA Power Networks' proposed revenue and our preliminary decision: rate of return, depreciation and operating and capital expenditure. We discuss each of these below.

Rate of return

Significant investment is required to build a distribution network. The return SA Power Networks 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 preliminary decision sets the allowed rate of return (or 'cost of capital') at 5.45 per cent in 2015–16. We have not accepted SA Power Networks' proposed rate of return of 7.62 per cent.[i]

The investment environment has improved since our previous decision, which was made during the height of uncertainty surrounding the global financial crisis. This improvement translates to lower financing costs necessary to attract efficient investment.

The lower rate of return in this decision will reduce SA Power Networks' average annual revenue requirements compared to the past.

Depreciation

Depreciation (or 'return of capital') is the allowance provided so capital investors recover their investment over the economic life of the asset. The effect of changes in depreciation is to move forward or backward in time when SA Power Networks receives its deprecation allowance.

Our preliminary decision is to reduce SA Power Networks' proposed depreciation allowance for the 2015–20 regulatory control period by $402.3 million ($nominal) to $533.7 million ($nominal). This is 43 per cent less than SA Power Networks' proposed.

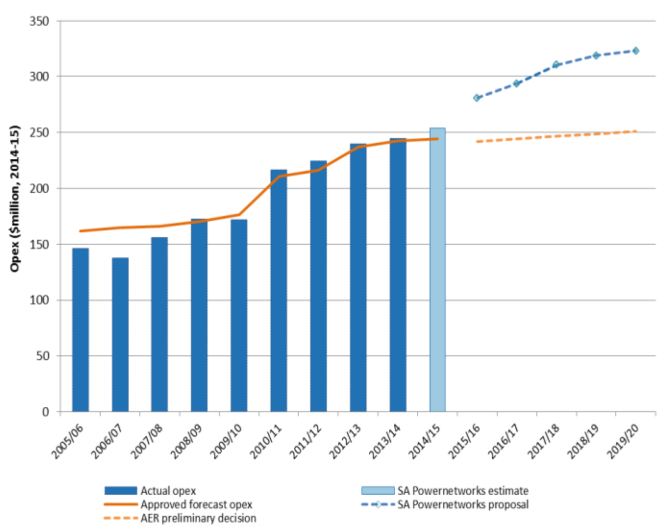
Our lower deprecation allowance is driven by our different method to derive remaining asset lives, compared to SA Power Networks' proposed approach. The difference in approach means SA Power Networks will recover its investment from customers more gradually.

Operating expenditure

Operating expenditure (opex) includes forecast operating, maintenance and other non-capital costs incurred in the provision of transmission network services. It includes labour costs, maintenance costs, and other non-capital costs that SA Power Networks is likely to require during the 2014–19 period for the efficient operation of its network.

We did not accept SA Power Networks' proposed $1527.2 million ($2014–15) opex forecast. Our final decision allows $1232.9 million ($2014–15). This is 19.3 per cent less than SA Power Networks proposed.

AER preliminary decision compared to SA Power Networks' past and proposed opex ($million, 2014-15)



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.

We are not satisfied that SA Power Networks' proposed forecast operating expenditure reasonably reflects the opex criteria. While we have accepted SA Power Networks' base opex, we have not accepted several of its proposals for opex step changes—increases in revenue for changed regulatory or environmental conditions. We consider SA Power Networks has not demonstrated that such revenue increases are necessary to provide distribution services.

Capital expenditure

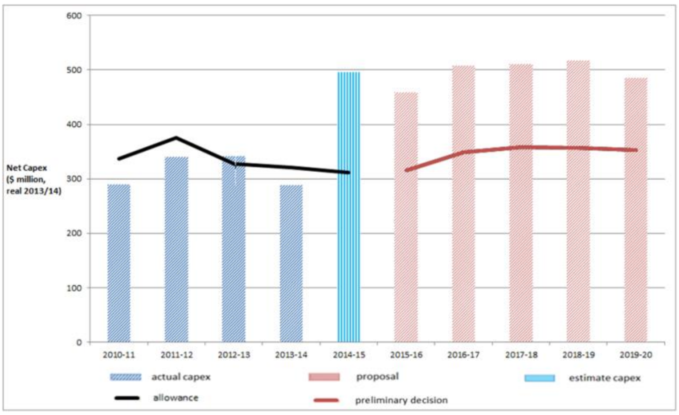
Capital expenditure (capex) refers to the cost of building new facilities or replacing existing infrastructure. Factors that influence the required level of capex include the age and condition of existing assets.

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

Under our preliminary decision, SA Power Networks can recover $1684.0 million ($2014−15) for capex. This is 68 per cent of the $2481.0 million SA Power Networks proposed.

The main driver for our substitute capex forecast is our assessment that SA Power Networks has not demonstrated that its service level requirements or other obligations have changed to require the additional capex funding it has proposed.

AER preliminary decision compared to SA Power Networks' past and proposed capex ($million, 2014-15)



For more information:

More information on our preliminary decision can be found on our website: [www.aer.gov.au.](http://www.aer.gov.au)

---

[i] The rate of return SA Power Networks 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 SA Power Networks submitted its proposal. More information on the rate of return can be found in our Rate of Return Fact Sheet.