



# **DRAFT DECISION**

## **AusNet Services Distribution Determination 2021 to 2026**

### **Attachment 1 Annual revenue requirement**

September 2020

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## Note

This attachment forms part of the AER's draft decision on the distribution determination that will apply to AusNet Services for the 2021–26 regulatory control period. It should be read with all other parts of the draft decision.

The draft decision includes the following attachments:

### Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Rate of return

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 8 – Efficiency benefit sharing scheme

Attachment 9 – Capital expenditure sharing scheme

Attachment 10 – Service target performance incentive scheme

Attachment 11 – Demand management incentive scheme and demand management innovation allowance mechanism

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# 1 Annual revenue requirement

This attachment sets out our draft decision on AusNet Services' annual revenue requirement (ARR) for the provision of standard control services (SCS) over the 2021–26 regulatory control period. Specifically, it sets out our draft decision on:

- the ARRs (unsmoothed), which are the sum of annual building block costs
- the total revenue requirement, which is the sum of the ARRs
- the annual expected revenues (smoothed)
- the X factors.

We determine AusNet Services' ARR using a building block approach. We determine the X factors by smoothing the ARR over the regulatory control period. The X factor is used in the CPI–X methodology to determine the annual expected revenue (smoothed).

## 1.1 Draft decision

We determine a total ARR of \$3252.2 million (\$ nominal) for AusNet Services for the 2021–26 regulatory control period, reflecting our draft decision on the various building block costs. This is a reduction of \$168.2 million (\$ nominal) or 4.9 per cent to AusNet Services' proposed total ARR of \$3420.5 million (\$ nominal).

We determine the annual expected revenue (smoothed) and X factor for each regulatory year of the 2021–26 regulatory control period by smoothing the ARR. Our draft decision is to approve total expected revenues (smoothed) of \$3259.3 million (\$ nominal) for AusNet Services for the 2021–26 regulatory control period.

Table 1.1 shows our draft decision on the building block costs, the ARR, annual expected revenue and X factor for the 2021–26 regulatory control period.

**Table 1.1 AER's draft decision on AusNet Services' revenues for the 2021–26 regulatory control period (\$ million, nominal)**

	2021–22	2022–23	2023–24	2024–25	2025–26	Total
Return on capital	218.1	215.5	213.5	211.3	207.9	1066.4
Regulatory depreciation <sup>a</sup>	162.5	140.0	138.9	144.5	147.6	733.5
Operating expenditure <sup>b</sup>	240.4	247.6	253.9	262.0	271.1	1275.0
Revenue adjustments <sup>c</sup>	82.1	50.7	29.4	8.7	6.5	177.4
Cost of corporate income tax	0.0	0.0	0.0	0.0	0.0	0.0
Annual revenue requirement (unsmoothed)	703.0	653.8	635.7	626.6	633.2	3252.2
<b>Annual expected revenue (smoothed)</b>	<b>651.6</b>	<b>651.7</b>	<b>651.9</b>	<b>652.0</b>	<b>652.1</b>	<b>3259.3</b>
X factor <sup>d</sup>	n/a <sup>e</sup>	2.30%	2.30%	2.30%	2.30%	n/a

Source: AER analysis.

- (a) Regulatory depreciation is straight-line depreciation net of the inflation indexation on the opening regulatory asset base (RAB).
- (b) Includes debt raising costs.
- (c) Includes revenue adjustments from the efficiency benefit sharing scheme (EBSS), the capital expenditure sharing scheme (CESS) and the demand management innovation allowance mechanism (DMIAM).
- (d) The X factors will be revised to reflect the annual return on debt update. Under the CPI–X framework, the X factor measures the real rate of change in annual expected revenue from one year to the next. A negative X factor represents a real increase in revenue. Conversely, a positive X factor represents a real decrease in revenue.
- (e) AusNet Services is not required to apply an X factor for 2021–22 because we set the 2021–22 expected revenue in this decision. The expected revenue for 2021–22 is around 6.0 per cent lower than the approved total annual revenue for 2020 in real terms, or 3.8 per cent lower in nominal terms after taking into account the escalation by half year CPI to allow comparison of the revenue from 1 July 2021 onwards.

## 1.2 AusNet Services' proposal

AusNet Services proposed a total expected revenues (smoothed) of \$3430.8 million (\$ nominal) for the 2021–26 regulatory control period.

Table 1.2 shows AusNet Services' proposed building block costs, the ARR, expected revenue and X factor for each year of the 2021–26 regulatory control period.

**Table 1.2 AusNet Services' proposed revenues for the 2021–26 regulatory control period (\$ million, nominal)**

	2021–22	2022–23	2023–24	2024–25	2025–26	Total
Return on capital	228.3	231.2	232.7	233.9	233.8	1160.0
Regulatory depreciation <sup>a</sup>	138.2	149.8	156.2	165.5	174.4	784.0
Operating expenditure <sup>b</sup>	245.6	255.4	265.5	275.9	285.6	1327.9

Revenue adjustments <sup>c</sup>	58.4	52.7	27.6	4.8	4.9	148.5
Cost of corporate income tax	0.0	0.0	0.0	0.0	0.0	0.0
Annual revenue requirement (unsmoothed)	670.6	689.1	682.0	680.0	698.7	3420.5
<b>Annual expected revenue (smoothed)</b>	<b>631.2</b>	<b>657.6</b>	<b>685.0</b>	<b>713.6</b>	<b>743.4</b>	<b>3430.8</b>
X factor	n/a <sup>d</sup>	-1.69%	-1.69%	-1.69%	-1.69%	n/a

Source: AusNet Services, *Distribution Proposal PTRM model (2022–26)*, January 2020.

- (a) Regulatory depreciation is straight-line depreciation net of the inflation indexation on the opening RAB.
- (b) Includes debt raising costs.
- (c) Includes revenue adjustments from EBSS, CESS and DMIAM.
- (d) AusNet Services is not required to apply an X factor for 2021–22 because we set the 2021–22 expected revenue in this decision.

### 1.3 Assessment approach

In this section, we describe the approach used to determine the ARR and expected revenue for AusNet Services for each year of the 2021–26 regulatory control period.<sup>1</sup>

In this determination we first calculate the ARR for each year of the 2021–26 regulatory control period. To do this we consider the various costs facing the distributor and the trade-offs and interactions between these costs, service quality and across years. This reflects our holistic assessment of the distributor's proposal.

The ARR for each year is the sum of the building block costs. These building block costs are set out in section 1.3.1. The AER's post-tax revenue model (PTRM) brings together these building block costs and calculates the resulting ARRs.

We understand the trade-offs that occur between building block costs and test the sensitivity of these costs to their various driver elements. These trade-offs are discussed in the interrelationships section of the various attachments to this draft decision and are reflected in the calculations made in the PTRM.<sup>2</sup> Such understanding allows us to exercise judgement in determining the final inputs into the PTRM and the ARRs that result from this modelling.

Having calculated the total revenue requirement for the 2021–26 regulatory control period, we smooth the ARRs for each regulatory year across that period. This step reduces revenue variations between years, and calculates the expected revenue and X

<sup>1</sup> NER, cl. 6.3.2(a)(1), 6.5.9(b)(2).

<sup>2</sup> There are trade-offs that are not modelled in the PTRM but are reflected in the inputs to the PTRM. For example, service quality is not explicitly modelled in the PTRM, but the trade-offs between service quality and price are reflected in the forecast capital expenditure and operating expenditure inputs to the model. Other trade-offs are obvious from the calculations in the PTRM. For example, while someone may expect a lower regulatory asset base to also lower revenues, the PTRM shows that this will not occur if the reduction in the regulatory asset base is due solely to an increase in the depreciation rate. In such circumstances, revenues increase as the increased depreciation more than offsets the reduction in the return on capital caused by the lower regulatory asset base.

factor for each year.<sup>3</sup> The X factors equalise (in net present value terms) the total expected revenues to be earned by the distributor with the total revenue requirement for the 2021–26 regulatory control period.<sup>4</sup> They must usually minimise, as far as reasonably possible, the variance between the expected revenue and ARR for the last regulatory year of the period.<sup>5</sup> By minimising this divergence, it helps to manage the prospect of a significant revenue change (and consequently prices) between the last year of the 2021–26 regulatory control period, and first year of the following 2026–31 regulatory control period. We therefore consider a divergence of up to 3 per cent between the expected revenue and ARR for the last year of the regulatory control period is reasonable, if this can promote smoother price changes over the regulatory control period.

The building block costs (and the elements that drive those costs) used to determine the unsmoothed ARR are set out in section 1.3.1.

### 1.3.1 The building block costs

The efficient costs to be recovered by a distributor can be thought of as being made up of various building block costs. Our draft decision assesses each of the building block costs and the elements that drive these costs. The building block costs are approved reflecting trade-offs and interactions between the cost elements, service quality and across years.

Table 1.3 shows the building block costs that form the ARR for each year and where discussion on the elements that drive these costs can be found within this draft decision.

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<sup>3</sup> NER, cl. 6.5.9(a).

<sup>4</sup> NER, cl. 6.5.9(b)(3)(i). The X factors represent the real revenue path over the 2021–26 regulatory control period under the CPI–X framework.

<sup>5</sup> NER, cl. 6.5.9(b)(2).



**Table 1.3 Building block costs**

Building block costs	Attachments where elements are discussed
Return on capital	Regulatory asset base (attachment 2)
	Rate of return (attachment 3)
	Capital expenditure (attachment 5)
Regulatory depreciation (return of capital)	Regulatory asset base (attachment 2)
	Regulatory depreciation (attachment 4)
	Capital expenditure (attachment 5)
Operating expenditure	Operating expenditure (attachment 6)
Estimated cost of corporate tax	Corporate income tax (attachment 7)
Other revenue adjustments	
Adjustment for shared assets	Annual revenue requirement (attachment 1)
Operating efficiency benefits/penalties	Efficiency benefit sharing scheme (attachment 8)
Capital efficiency benefits/penalties	Capital expenditure sharing scheme (attachment 9)
Demand management innovation allowance	Demand management incentive scheme (attachment 11)

## 1.4 Reasons for draft decision

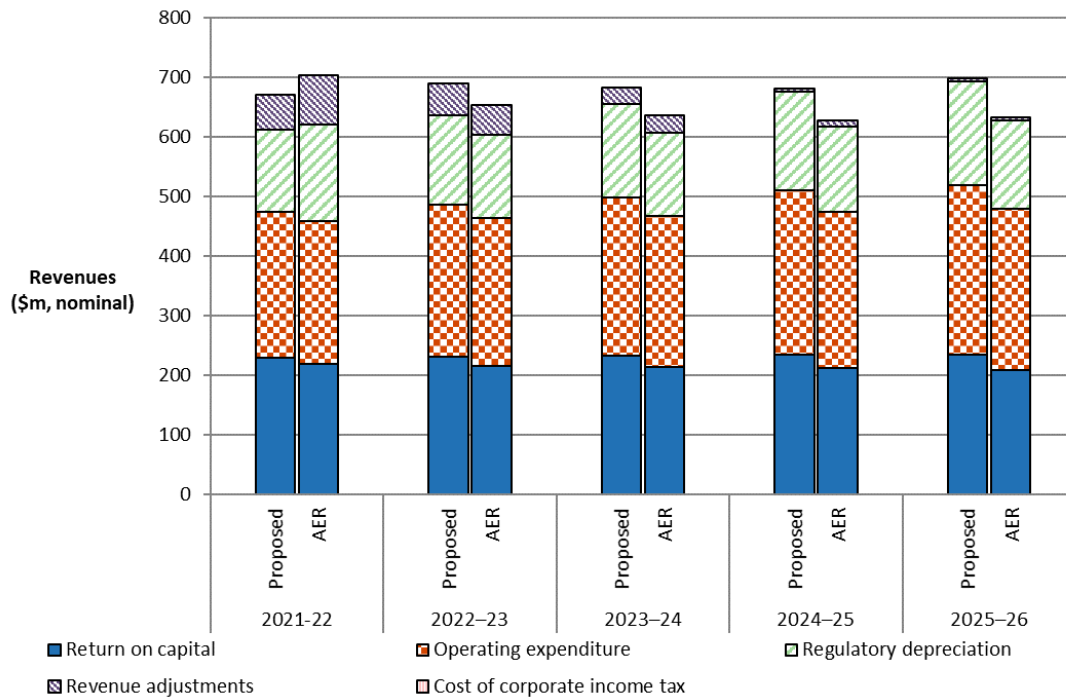
We determine a total ARR of \$3252.2 million (\$ nominal) for AusNet Services over the 2021–26 regulatory control period. This is a reduction of \$168.2 million (\$ nominal) or 4.9 per cent to AusNet Services' proposed total ARR of \$3420.5 million (\$ nominal) for this period. This reflects the impact of our draft decision on the various building block costs.

The changes we made to AusNet Services' proposed building blocks include (in nominal terms):

- a reduction in the return on capital of \$93.6 million or 8.1 per cent (attachments 2, 3 and 5).
- a reduction in the regulatory depreciation of \$50.5 million or 6.4 per cent (attachments 2, 4 and 5).
- a reduction in the operating expenditure (opex) forecast of \$52.9 million or 4.0 per cent (attachment 6).
- no change to the cost of corporate income tax of zero (attachment 7).
- an increase in the revenue adjustments of \$28.8 million or 19.4 per cent (attachments 8, 9 and 11).

Figure 1.1 shows the building block components from our determination that make up the ARR for AusNet Services, and the corresponding components from its proposal.

**Figure 1.1 AER's draft decision and AusNet Services' proposed annual revenue requirement (\$ million, nominal)**



Source: AER analysis; AusNet Services, *Distribution Proposal PTRM model (2022–26)*, January 2020.

Note: Revenue adjustments include EBSS, CESS and DMIAM amounts. Opex includes debt raising costs.

### 1.4.1 X factor and annual expected revenue

Part of the scope of AusNet Services' 'New Reg' process was to negotiate with its Customer Forum, a preferred smoothed revenue profile for the 2021–26 regulatory control period on a per customer basis. This smoothed revenue per customer metric was termed the 'price path'. AusNet Services' Customer Forum was presented with 3 NPV neutral 'price path' options and its final negotiated price path outcome was to maximise the year 1 reduction while maintaining zero change in real terms on a per customer basis in years 2 to 5 of the regulatory control period.<sup>6</sup> To achieve zero real change in those final years, AusNet Services matched the expected increase in real revenues (proposing increases of 1.69 per cent per annum) to the forecast annual increase in customer numbers. AusNet Services' proposed approach to revenue smoothing appears broadly consistent with this negotiated outcome.

To maintain net present value (NPV) and minimise the difference between expected smoothed and unsmoothed revenues at the end of a regulatory control period, it is not always possible to achieve a revenue profile that has been negotiated before our determination outcomes are known. In the present circumstances, we have been able

<sup>6</sup> AusNet Services EDPR Customer Forum, *Final Engagement Report*, 31 January 2020, p. 48.

to achieve a significant reduction to the revenue for 2021–22 as sought by the Customer Forum.

This first year reduction would have been significantly larger had we also smoothed revenues over the remaining four years with the aim of flat real prices on a per customer basis. However, we do not consider such an approach is appropriate now that the draft decision outcomes are known. For the reasons discussed in section 1.4.4, we have concerns with the use of customer numbers as the measure of demand for bill impact estimation purposes.

More importantly for present purposes, applying flat real prices on a per customer basis, would have resulted in a significant divergence of over 11 per cent between smoothed and unsmoothed revenues for the final year of the regulatory control period. Such a difference sets up a prospect for significant price adjustments at the start of the subsequent regulatory control period. We noted the National Electricity Rules (NER) requirement in our guidance note on the revenue path smoothing for facilitating the New Reg process.<sup>7</sup> Our approach for this draft decision is to keep the final year divergence to 3 per cent. It also results in real decreases in price per customer over the subsequent four years, rather than the flat prices as proposed.

Accordingly, we determine an X factor for AusNet Services of 2.30 per cent per annum for the four years of the regulatory control period from 2022–23 to 2025–26.<sup>8</sup> The NPV of the ARR is \$2869.8 million (\$ nominal) as at 1 July 2021. Based on this NPV and applying the CPI–X framework we determine that the expected revenue (smoothed) for AusNet Services is \$651.6 million in 2021–22 increasing to \$652.1 million in 2025–26 (\$ nominal). The resulting total expected revenue for AusNet Services is \$3259.3 million for the 2021–26 regulatory control period.

We have also reviewed our estimate of the 2020–21 starting revenue in the PTRM. We consider the 2020 total allowed revenue from AusNet Services' approved pricing proposal, escalated by half year CPI, should form this estimate of \$677.4 million, as this is the latest available estimate that we have approved.<sup>9</sup> This estimated 2020–21 starting revenue will form the base year to calculate the percentage change for the first year of the 2021–26 regulatory control period ( $P_0$ ) for our draft decision.

Figure 1.2 shows our draft decision on AusNet Services' annual expected revenue (smoothed revenue) and the ARR (unsmoothed revenue) for the 2021–26 regulatory control period. For comparative purposes, the revenue for 2021 is shown as double the estimate for the six month extension period between 1 January 2021 and 30 June 2021.<sup>10</sup>

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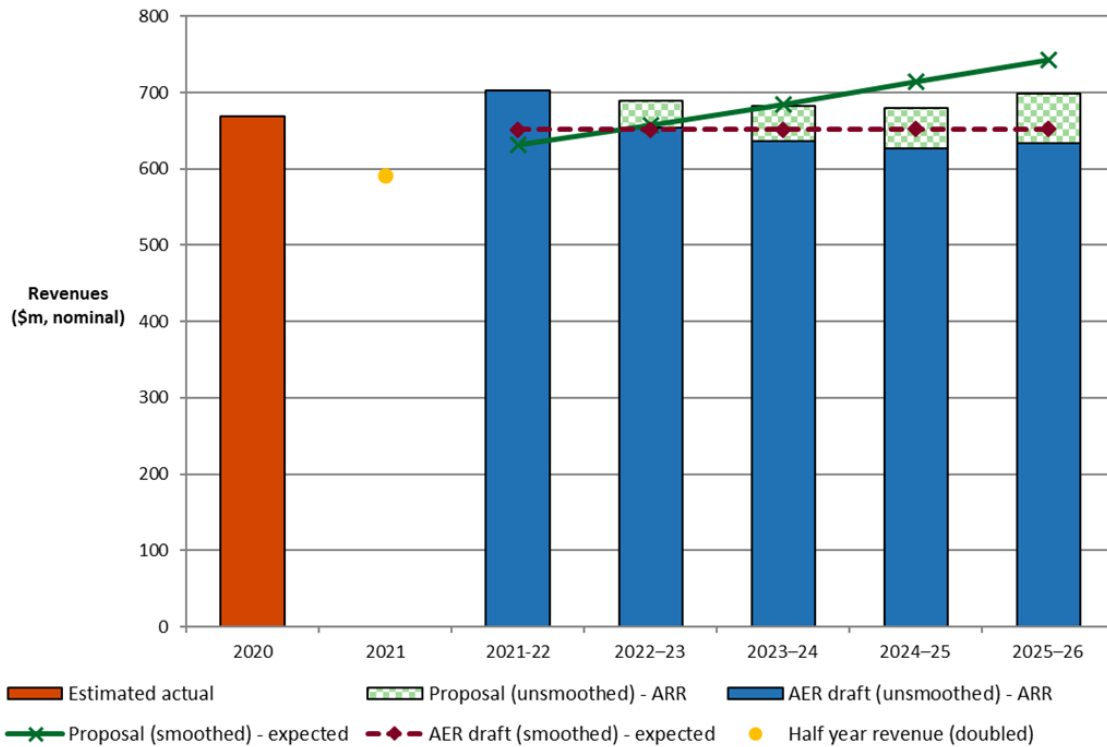
<sup>7</sup> AER, *AusNet Trial – AER staff guidance note 6: Revenue path profile*, 29 August 2018.

<sup>8</sup> AusNet Services is not required to apply an X factor for 2021–22 because we set the 2021–22 expected revenue in this decision.

<sup>9</sup> AusNet Services, *Revised pricing proposal 2020*, 7 October 2019, p. 12.

<sup>10</sup> AER, *Re: Victorian distribution reset - 6 month extension period - Final approach*, 17 August 2020

**Figure 1.2 AER's draft decision on AusNet Services' revenue for the 2021–26 regulatory control period (\$ million, nominal)**



Source: AER analysis; AusNet Services, *Distribution Proposal PTRM model (2022–26)*, January 2020.

Note: Revenue for 2021 is based on doubling the estimate for the half year period between 1 January 2021 and 30 June 2021.

Energy Consumers Australia submitted that its preference is for a smooth price path that minimises price volatility for customers.<sup>11</sup> Red Energy and Lumo Energy submitted the price transition should be smooth across years, as sharp price movements increase bill affordability concerns and send less appropriate signals to encourage consumers to consider the profile of their energy use.<sup>12</sup> We have considered the submissions and taken into account the building block costs determined in this draft decision when smoothing the expected revenues for AusNet Services over the 2021–26 regulatory control period. In doing so, we have set the expected revenue for the first regulatory year at \$651.6 million (\$ nominal) which is \$51.4 million lower than the ARR for that year. We then apply an expected inflation rate of 2.37 per cent per annum and an X factor of 2.30 per cent per annum to determine the expected revenue in subsequent years.<sup>13</sup> We consider that our profile of X factors results in an expected

<sup>11</sup> Energy Consumers Australia, *Victorian Electricity Distributors Regulatory Proposals 2021–2026 Submission*, 16 June 2020, p. 15.

<sup>12</sup> Red Energy and Lumo Energy, *Submission to the Issues Paper - Victorian electricity distribution determination, 2021 to 2026*, 19 June 2020, p. 3.

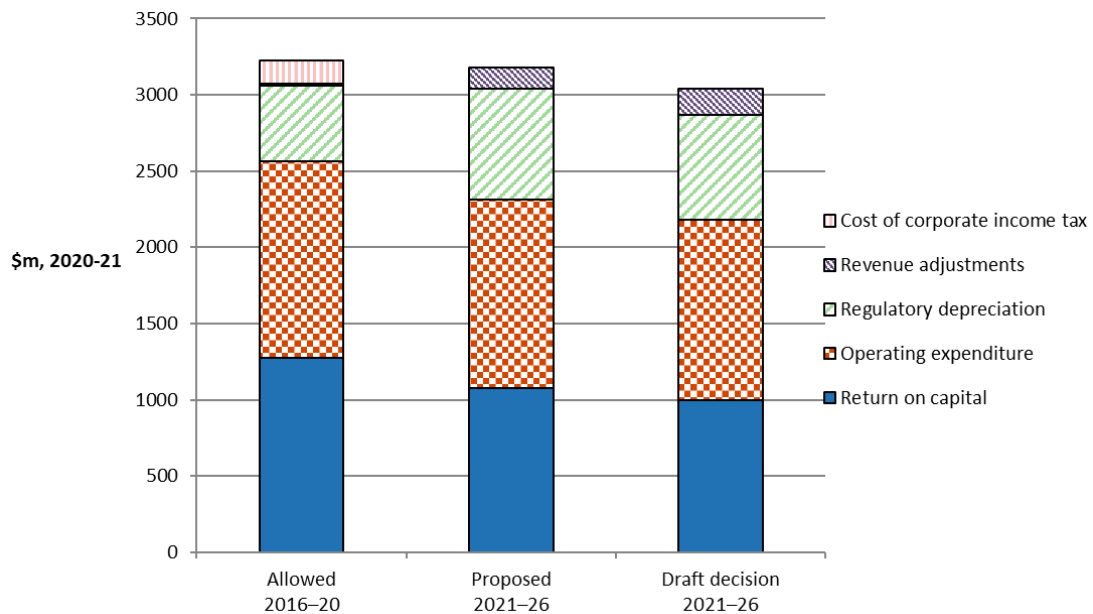
<sup>13</sup> NER, cl. 6.5.9(a).

revenue in the last year of the regulatory control period that is as close as reasonably possible to the ARR for that year.<sup>14</sup> We will review this smoothing for the final decision.

Our draft decision results in an average decrease of 0.8 per cent per annum (\$ nominal) in the expected revenue over the 2021–26 regulatory control period.<sup>15</sup> This consists of an initial decrease of 3.8 per cent from 2020–21 to 2021–22, and then stays relatively constant during the remainder of the 2021–26 regulatory control period.<sup>16</sup> Our draft decision also results in a decrease of 5.8 per cent in real terms (\$2020–21) to AusNet Services’ average ARR relative to that in the 2016–20 regulatory control period. This is largely due to a lower weighted average cost of capital (and therefore lower return on capital), a lower operating expenditure (opex) forecast and a lower cost of corporate income tax in this draft decision for the 2021–26 regulatory control period than that approved in the 2016–20 determination.

Figure 1.3 compares our draft decision building blocks for AusNet Services’ 2021–26 regulatory control period with its proposed revenue requirement for the same period, and the approved revenue for the 2016–20 regulatory control period.

**Figure 1.3 Total revenue by building block components (\$ million, 2020–21)**



Source: AER analysis; AusNet Services, *Distribution Proposal PTRM model (2022–26)*, January 2020.

<sup>14</sup> NER, cl. 6.5.9(b)(2). We consider a divergence of up to 3 per cent between the expected revenue and ARR for the last year of the regulatory control period is appropriate, if this can achieve smoother price changes for users over the regulatory control period. In the present circumstances, based on the X factors we have determined for AusNet Services, this divergence is around 3.0 per cent.

<sup>15</sup> In real 2020–21 dollar terms, our approved expected revenue for AusNet Services results in an average decrease of 3.1 per cent per annum over the 2021–26 regulatory control period.

<sup>16</sup> In real 2020–21 dollar terms, this consists an initial decrease of 6.0 per cent from 2020–21 to 2021–22, followed by annual average decreases of 2.3 per cent during the remainder of the 2021–26 regulatory control period.

## 1.4.2 Shared assets

Distributors, such as AusNet Services, may use assets to provide both the SCS we regulate and unregulated services. These assets are called 'shared assets'.<sup>17</sup> If the revenue from shared assets is material, ten per cent of the unregulated revenues that a distributor earns from shared assets will be used to reduce the distributor's revenue for SCS.<sup>18</sup>

The shared asset principles establish that use of shared assets should be material before cost reductions are applied.<sup>19</sup> The NER does not define materiality in this context. Our approach to what constitutes a material use of shared assets is that unregulated use of shared assets in a specific regulatory year is material when a distributor's annual average unregulated revenue from shared assets is expected to be greater than one per cent of its expected revenue for that regulatory year.<sup>20</sup>

AusNet Services submitted that its total revenue requirement is not subject to a shared asset adjustment because its forecast annual unregulated revenue from shared assets does not exceed the AER's materiality threshold.<sup>21</sup>

We note AusNet Services' forecast unregulated revenues from shared assets for the 2021–26 regulatory control period are expected to decrease significantly from the 2016–20 period due to some of the shared asset unregulated services not earning any revenues for the 2021–26 regulatory control period. AusNet Services' forecast unregulated revenues must be compared to the regulated revenues we determine, rather than those proposed by AusNet Services. While our draft decision sets lower expected revenues than AusNet Services' proposal, we estimate that the unregulated revenues will be less than one per cent of its expected revenues in each year of the 2021–26 regulatory control period. Hence, the materiality threshold is not met in each year of the 2021–26 regulatory control period and we do not apply a shared asset revenue adjustment.<sup>22</sup>

## 1.4.3 Indicative average distribution price impact

Our draft decision on AusNet Services' expected revenues ultimately affects the prices consumers pay for electricity. There are several steps required in translating our revenue decision into indicative distribution price impact.

We regulate AusNet Services' SCS under a revenue cap form of control. This means our draft decision on AusNet Services' expected revenues does not directly translate to price impacts. This is because AusNet Services' revenue is fixed under the revenue

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<sup>17</sup> NER, cl. 6.4.4.

<sup>18</sup> AER, *Shared asset guideline*, November 2013, p 11.

<sup>19</sup> NER, cl. 6.4.4(c)(3).

<sup>20</sup> AER, *Shared asset guideline*, November 2013, p. 8.

<sup>21</sup> AusNet Services, *Appendix 8A - Shared Assets*, January 2020.

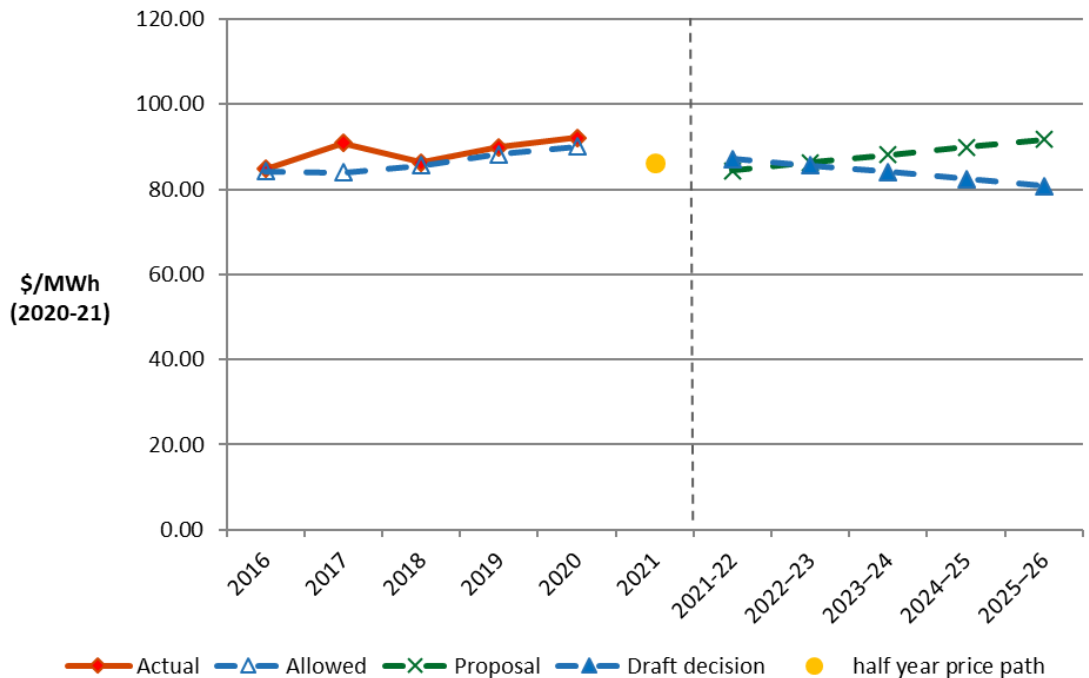
<sup>22</sup> We will reassess the materiality of the forecast shared asset unregulated revenues for our final decision.

cap form of control, so changes in the consumption of electricity will affect the prices ultimately charged to consumers. We are not required to establish the distribution prices for AusNet Services as part of this determination. However, we will assess AusNet Services' annual pricing proposals before the commencement of each regulatory year within the 2021–26 regulatory control period. In each assessment we will administer the pricing requirements set in this distribution determination.

For this draft decision, we have estimated some indicative average distribution price impacts flowing from our determination on the expected revenues for AusNet Services over the 2021–26 regulatory control period. In this section, our estimates only relate to SCS (that is, the core electricity distribution charges), not alternative control services (such as metering charges). These indicative price impacts assume that actual energy consumption across the 2021–26 regulatory control period matches AusNet Services' forecast energy consumption, which we have adopted for this draft decision. We also have not factored in any changes arising from incentive scheme amounts, cost pass throughs or unders/overs reconciliation that usually occur in the annual pricing process to come up with the total allowed revenue.

Figure 1.4 shows AusNet Services' indicative average price path over the period from 2016 to 2025–26 in real \$2020–21 dollar terms based on the expected revenues established in our draft decision compared to AusNet Services' proposed revenue requirement.

**Figure 1.4 Indicative distribution price path for AusNet Services (\$/MWh, 2020–21)**



Source: AER analysis.

Note: The price for 2021 is based on the revenue and energy throughput estimates for the half year period between 1 January 2021 and 30 June 2021.

We estimate that our draft decision on AusNet Services' annual expected revenue will result in a decrease to average distribution charges by about 2.6 per cent per annum over the 2021–26 regulatory control period in real 2020–21 dollar terms.<sup>23</sup> This compares to the real average decrease of approximately 0.1 per cent per annum proposed by AusNet Services over the 2021–26 regulatory control period.<sup>24</sup> These high-level estimates reflect the aggregate change across the entire network and do not reflect the particular tariff components for specific end users.

Table 1.4 displays in nominal terms the comparison of the revenue and price impacts of AusNet Services' proposal and our draft decision.

**Table 1.4 Comparison of revenue and price impacts of AusNet Services' proposal and the AER's draft decision (\$ nominal)**

	2020 <sup>b</sup>	2021–22	2022–23	2023–24	2024–25	2025–26
<b>AER draft decision</b>						
Revenue (\$million)	677.4	651.6	651.7	651.9	652.0	652.1
Price path (\$/MWh) <sup>a</sup>	92.16	89.27	89.79	90.17	90.50	90.79
Revenue (change)		–3.8%	0.0%	0.0%	0.0%	0.0%
Price path (change)		–3.1%	0.6%	0.4%	0.4%	0.3%
<b>AusNet Services proposal</b>						
Revenue (\$million)	677.4	631.2	657.6	685.0	713.6	743.4
Price path (\$/MWh) <sup>a</sup>	92.16	86.47	90.59	94.76	99.06	103.50
Revenue (change)		–6.8%	4.2%	4.2%	4.2%	4.2%
Price path (change)		–6.2%	4.8%	4.6%	4.5%	4.5%

Source: AER analysis; AusNet Services, *Distribution Proposal PTRM model (2022–26)*, January 2020

- (a) The price path is in nominal terms and is constructed by dividing nominal expected revenue for SCS by forecast energy consumption for each year of the regulatory control period.
- (b) This is based on AusNet Services' 2020 approved pricing proposal, and has been indexed by CPI for the half year period from 1 January 2021 to 30 June 2021 to allow comparison of the price path from 1 July 2021 onwards.

<sup>23</sup> In nominal terms we estimate average distribution charges to decrease by 0.3 per cent per annum. This amount reflects an expected inflation rate of 2.37 per cent per annum as determined in this draft decision.

<sup>24</sup> In nominal terms AusNet Services' proposal would increase distribution charges by 2.3 per cent per annum. This amount reflects an expected inflation rate of 2.45 per cent per annum as proposed by AusNet Services in its proposal.



#### 1.4.4 Expected impact of decision on electricity bills

The annual electricity bill for customers in AusNet Services' network reflects the combined cost of all the electricity supply chain components—wholesale energy generation, transmission, distribution, metering, and retail costs. This draft decision primarily relates to the distribution charges for SCS, which represent approximately 34.0 per cent on average for residential customers' and 39.0 per cent on average for small business customers' annual electricity bill in AusNet Services' network area.<sup>25</sup>

We estimate the expected bill impact by varying the distribution charges in accordance with our draft decision in this attachment, while holding all other components—including the metering component—constant.<sup>26</sup> This approach isolates the effect of our draft decision on the core distribution charges only. However, this does not imply that other components will remain unchanged across the regulatory control period.<sup>27</sup>

AusNet Services used a different approach to estimate the bill impacts of its proposal. It used a revenue per customer measure. AusNet Services noted in its response to our information request that it does not support our approach which is based on energy consumption rather than customer numbers. It submitted that our approach is only accurate where consumption per customer and customer numbers are fixed. We disagree with this statement. If it was true, we would simply use the change in revenues to measure the impact on prices, which is an extremely unlikely scenario.

To convert revenues to prices, a measure of demand is needed. However, there are various components of demand that cannot all be reflected in one simple measure. This complexity is reflected in the tariff components of annual pricing including differences between small and large customers. In this regard, there are:

- Fixed charges that are driven by customer numbers. This is AusNet Services' sole measure of demand. This measure does not control for expected changes in average consumption. It also simply treats large and small customers equally.<sup>28</sup> For example, the addition of one large customer could make it appear prices are rising, simply because of the significant increase in revenues associated with this single customer is then effectively spread over all customers.
- kWh charges that are driven by consumption levels. Consumption levels change due to both customer numbers and the expected average level of consumption of those customers. This is the measure we use for our pricing estimate. In terms, of

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<sup>25</sup> AusNet Services, *ASD - Workbook 7 - Bill Impacts 2022–26*, January 2020.

<sup>26</sup> We also have not factored in any changes arising from incentive scheme amounts, cost pass throughs or unders/overs reconciliation that usually occur in the annual pricing process to come up with the total allowed revenue.

<sup>27</sup> It also assumes that actual energy consumption will equal the forecast adopted in our draft decision. Since AusNet Services operates under a revenue cap, changes in energy consumption will also affect annual electricity bills across the 2021–26 regulatory control period.

<sup>28</sup> Even if segmented into customer groups, within customer groups there are likely to be a significant range of consumption levels.

the example above, the addition of a large customers would be reflected in an expected large increase in consumption so prices for other customers would not necessary appear to change much. This is what should be expected.

- There are usually various capacity charges. These charges measure demand at peak times, and charge for expected demand at those peak times. These charges are mostly associated with large customers. The impact of this demand measure is not captured by AusNet Services' approach. We acknowledge our approach is also imperfect. In this regard, a large customer's annualised demand at peak time and its forecast consumption can differ significantly. However, for example, declining consumption and declining peak demand are usually correlated to some degree.

AusNet Services stated it expects declining consumption and increasing customer numbers over the 2021–26 regulatory control period.<sup>29</sup> Even if such expectations are accurate, it would reflect the complex nature of pricing outcomes and would likely reflect differences ultimately observed between small and large customer pricing outcomes. In our view, using a simple customer number measure is unlikely to better capture these complexities.

In their response to our issues paper, CitiPower, Powercor and United Energy submitted that revenue per customer measure is inappropriate because each network has a different mix of residential and business customers which have significantly different energy needs. They submitted that the revenue per level of energy distributed to be more comparable.<sup>30</sup> Given these considerations and recognising that no approach is perfect, we consider our approach of using annual price path based on total revenue divided by expected energy levels is appropriate.

EnergyAustralia submitted customers require more transparency and consistency for reporting of customer bill impacts arising from proposals and AER decisions. It noted in particular that AusNet Services' proposal used revenues on a per customer basis to determine bill impacts, and stated that there is significant difference between the impacts so determined and those based on a per kWh.<sup>31</sup>

We agree that transparency and consistency are important. We have conducted our bill impact assessments in a consistent manner across regulatory decisions. As noted above, our assessment will ultimately differ from the actual impacts customer face for a number of reasons, not least because we only assess a proportion of the overall cost of electricity for a consumer. We have not adopted AusNet Services' approach in this draft decision, for the reasons discussed above. For this draft decision, our approach is based on revenue per kWh, and has been consistently applied across the Victorian distributors to provide reasonable comparisons.

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<sup>29</sup> AusNet Services, *Response to AER information request #045*, 06 July 2020.

<sup>30</sup> CitiPower, Powercor and United Energy, *Response to AER's Issues Paper*, April 2020, p. 17.

<sup>31</sup> EnergyAustralia, *Submission on the Victorian Electricity Distribution Regulatory Proposal 2021–26*, 3 June 2020, pp. 1-4.

Based on this approach, we expect that our draft decision on the distribution component will decrease the average annual residential electricity bill in 2025–26 by about \$8 (\$ nominal) or 0.5 per cent from the 2020 total bill level. By comparison, had we accepted AusNet Services' proposal, the expected change in the distribution component would increase the average annual residential electricity bill in 2025–26 by about \$70 (\$ nominal) or 4.2 per cent from the 2020 total bill level.

Similarly, for an average small business customer, we expect that our draft decision on the distribution component will decrease the average annual electricity bill in 2025–26 by about \$46 (\$ nominal) or 0.6 per cent from the 2020 total bill level. By comparison, had we accepted AusNet Services' proposal, the expected change in the distribution component would increase the average annual small business electricity bill in 2025–26 by about \$381 (\$ nominal) or 4.8 per cent from the 2020 total bill level.

Our estimated impact is based on an average annual electricity usage of around 4 000 kWh per annum for residential households and 20 000 kWh per annum for small businesses.<sup>32</sup> Therefore, customers with different usage will experience different changes in their bills. We also note that there are other factors, such as metering, wholesale and retail costs, which affect electricity bills.

Table 1.5 shows our estimated impact of our draft decision and AusNet Services' proposal on the average annual electricity bills for residential and small business customers in its network over the 2021–26 regulatory control period.

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<sup>32</sup> Essential Services Commission, *Victorian Default Offer to apply from 1 January 2020 - Final decision*, 18 November 2019, pp. 72–73.

**Table 1.5 Estimated impact of AusNet Services' proposal and AER's draft decision on annual electricity bills for the 2021–26 regulatory control period (\$ nominal)**

	2020	2021–22	2022–23	2023–24	2024–25	2025–26
<b>AER draft decision</b>						
Residential annual bill	1666 <sup>a</sup>	1648	1651	1654	1656	1658
Annual change <sup>c</sup>		-18 (-1.1%)	3 (0.2%)	2 (0.1%)	2 (0.1%)	2 (0.1%)
Small business annual bill	7945 <sup>b</sup>	7847	7865	7878	7889	7898
Annual change <sup>c</sup>		-97 (-1.2%)	18 (0.2%)	13 (0.2%)	11 (0.1%)	10 (0.1%)
<b>AusNet Services proposal</b>						
Residential annual bill	1666 <sup>a</sup>	1631	1656	1682	1708	1736
Annual change <sup>c</sup>		-35 (-2.1%)	25 (1.6%)	26 (1.5%)	26 (1.6%)	27 (1.6%)
Small business annual bill	7945 <sup>b</sup>	7753	7892	8032	8177	8326
Annual change <sup>c</sup>		-191 (-2.4%)	139 (1.8%)	140 (1.8%)	145 (1.8%)	149 (1.8%)

Source: AER analysis; Essential Services Commission, *Victorian Default Offer to apply from 1 January 2020 - Final decision*, 18 November 2019, p. 76.

- (a) Annual bill for 2020 is sourced from Essential Services Commission, *Victorian Default Offer to apply from 1 January 2020 - Final decision* and reflects the average consumption of 4000 kWh for residential customers in Victoria. This is then indexed by CPI for the half year period from 1 January 2021 to 30 June 2021 to allow comparison of the bill impact from 1 July 2021 onwards.
- (b) Annual bill for 2020 is sourced from Essential Services Commission, *Victorian Default Offer to apply from 1 January 2020 - Final decision* and reflects the average consumption of 20000 kWh for small business customers in Victoria. This is then indexed by CPI for the half year period from 1 January 2021 to 30 June 2021 to allow comparison of the bill impact from 1 July 2021 onwards.
- (c) Annual change amounts and percentages are indicative. They are derived by varying the distribution component of the 2020 bill amounts in proportion to yearly expected revenue divided by forecast energy as provided by AusNet Services. Actual bill impacts will vary depending on electricity consumption and tariff class.

## Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
ARR	annual revenue requirement
CESS	capital expenditure sharing scheme
CPI	consumer price index
DMIAM	demand management innovation allowance mechanism
EBSS	efficiency benefit sharing scheme
NER	National Electricity Rules
NPV	net present value
opex	operating expenditures
PTRM	post-tax revenue model
RAB	regulatory asset base
SCS	standard control services