June 2021

Statement of reasons: United Energy's Annual Pricing Proposal

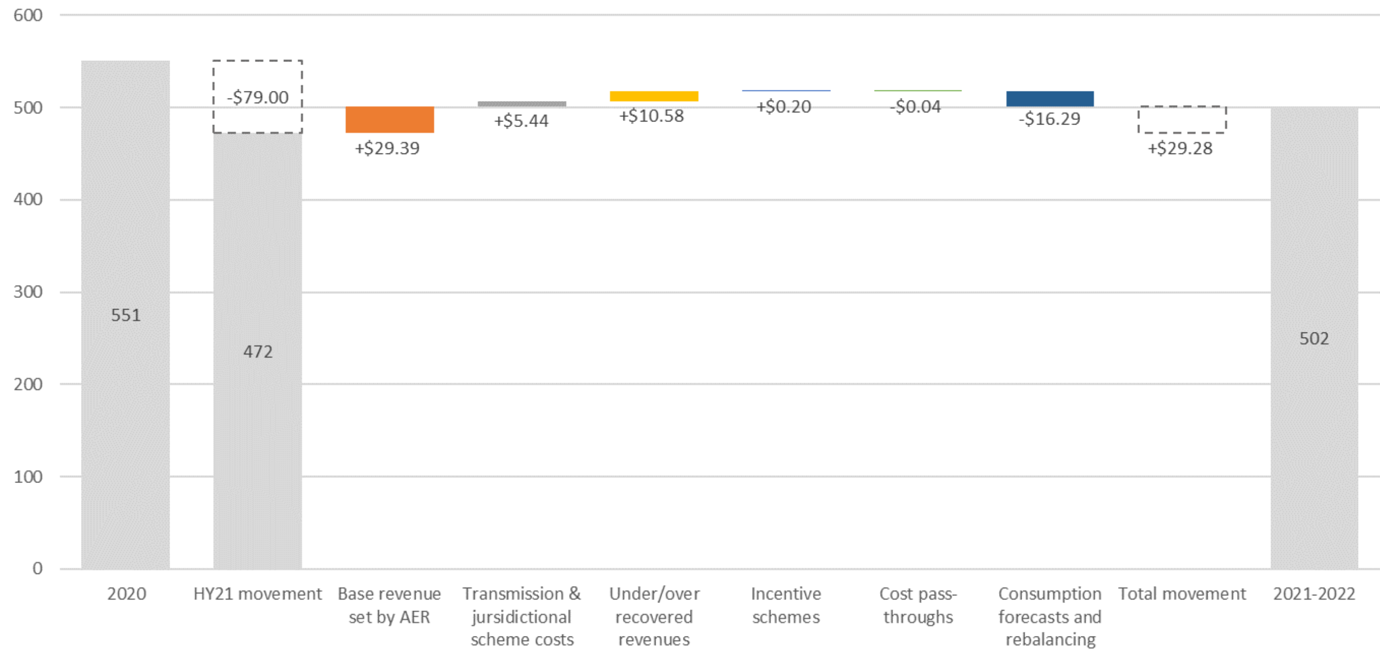
The AER approves United Energy's final pricing proposal and the tariffs contained within for commencement on 1 July 2021. The approved 2021–22 tariffs for United Energy are set out on our website.

The 2021–22 tariffs will apply for the first period of the 2021–26 regulatory control period. This is the final step in transitioning Victorian distributors from operating on calendar years to financial years for regulatory periods. This was a two-step process in making our 2021–26 determination. In the first step, we approved prices for 6 months from 1 January to reflect the lower cost of capital that would apply in our 2021–26 determination. The second step was to approve prices from 1 July based on our final decision. As a result of this process, lower prices were experienced for 6 months, before returning to normal price levels.

Estimated network cost movements

We estimate the network component of the typical bill for United Energy customers to be $29 higher for households and $22 lower for small businesses in the 2021–22 period. This is relative to current prices in the 6-month extension period from 1 January to 30 June 2021 (**HY21**).[1] Compared to 2020, network costs are estimated to be $50 lower for households, and $247 lower for small businesses. These movements are estimated for residential and small business customers on the main flat rate tariffs. Customers who switch to cost-reflective time-of-use tariffs are expected to experience lower total network costs.

Figure 1 Residential network cost movements

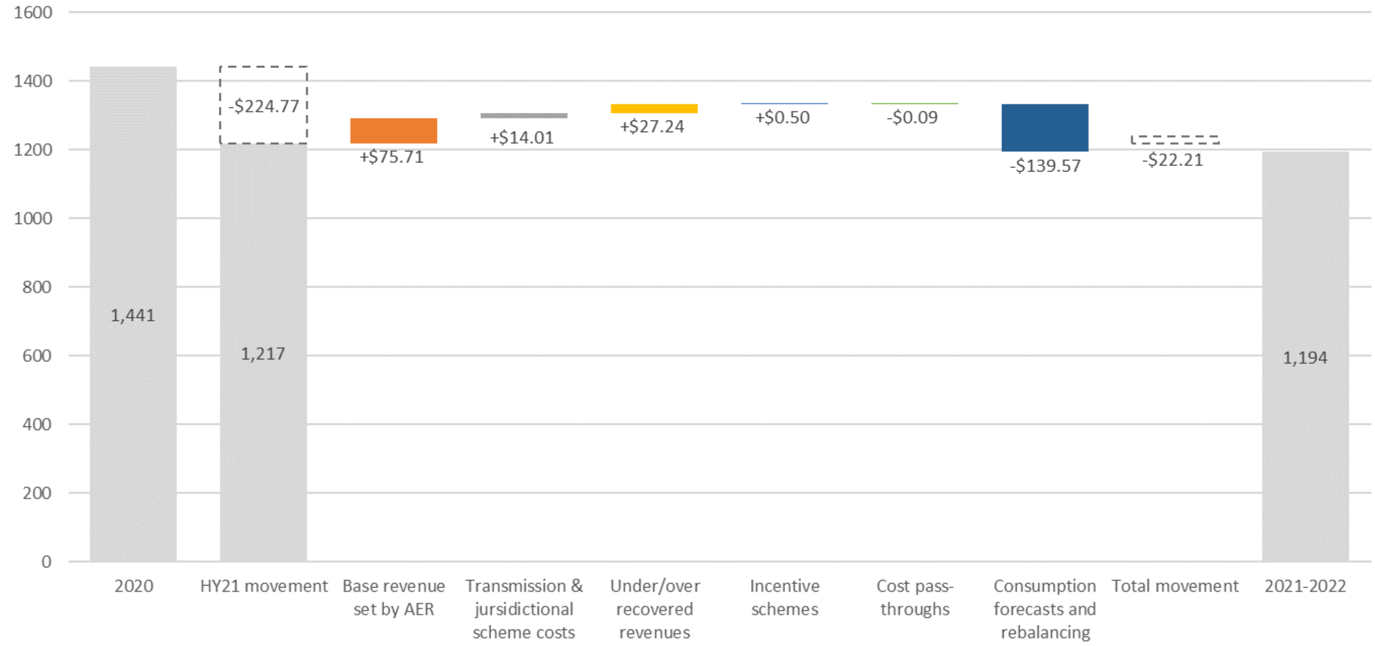


Source: AER Analysis; RIN data; United Energy's 2020, HY21, and 2021–22 pricing proposals.
Notes: The above analysis assumes electricity usage of 4,740kWh. This is based on the most recent data for residential electricity usage and customer numbers reported in United Energy's 2020 economic benchmarking RIN. All adjustments other than consumption forecasts and rebalancing are adjustments to total revenues and are indicative only at the tariff level.

[1] Adjustments have been made to HY21 prices where relevant (e.g. adjusting fixed annual charges) to enable comparison with 2021–22 prices.

Estimated network cost movements include both network tariffs and metering charges.[2] Actual bill impacts will vary from these estimates – for example, because customers are on different tariffs or consume different amounts of energy from our baseline assumption. We note that electricity retailers ultimately determine how these underlying network tariffs are reflected in the retail prices offered to customers.

Figure 2 Small business network cost movements



Source: AER Analysis; RIN data; United Energy's 2020, HY21, and 2021–22 pricing proposals.
Notes: The above analysis assumes electricity usage of 11,734kWh. This is based on the most recent data for non-residential non-demand electricity usage and customer numbers reported in United Energy's 2020 economic benchmarking RIN. All adjustments other than consumption forecasts and rebalancing are adjustments to total revenues and are indicative only at the tariff level.

The charts above represent the estimated total network cost movements between the 2020, HY21, and 2021–22 periods. These charts show the impact of different parts of our determinations and pricing processes. To calculate the estimated cost movements, we use consumption profiles from the most recent economic benchmarking regulatory information notice (RIN) data.[3] These cost movements reflect a decrease in costs in the HY21 period delivering on the decreases of our 6-month variation decision, and an increase in the 2021–22 period. This increase reflects the remainder of the impacts from our determination that may have normally been offset by those decreases that were delivered to customers early.[4]

United Energy's cost movements are largely driven by increases in allowed revenue under our determination, as well as a result of previous under-recoveries offset by rebalancing of the price levels of tariffs. This rebalancing reflects that United Energy has set new price levels for tariffs in

---

2 Network cost movements reflect the movements in prices for the most common residential and small business tariffs from the previous period. RIN-based consumption profiles are used to calculate an estimated network cost for each period. Small business consumption profiles are based on non-residential non-demand customer data, being the most representative data available.

3 Available on our website at https://www.aer.gov.au/networks-pipelines/performance-reporting.

4 Our final decisions for both the six-month variation and the 2021–26 determination are available on our website at https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/united-energy-determination-2021-26.

line with the new 2021–26 tariff structure statement. For residential customers, this rebalancing has not offset all of the increases, but for small business customers, the rebalancing has led to estimated decreases in 2021–22.

The price movements presented here are based on the main flat rate tariffs for residential and small business customers. United Energy provides a range of tariffs for each type of customer and the expected movements can vary across different tariffs. This reflects the discretion United Energy has in applying price movements across tariffs in line with its approved tariff structure statement, as well as changes in consumption levels for particular types of customers (for example higher residential consumption due to more people working from home). Where overall price movements are small, some types of tariffs may increase while others decrease, as can be seen in the case of United Energy.

Consumption forecasts

As electricity distributors operate under a revenue cap, we set the annual revenue that they can recover. Prices are set based on forecast consumption for that period, allowing distributors to recover their allowed revenue. If distributors forecast lower consumption, then prices are expected to be higher to allow them to recover the revenue allowed to deliver safe and reliable electricity within their networks.

Our assessment of the distributors' consumption forecasts includes analysis of historical consumption trends and the reasons put forward for any departure from them. For the 2021–22 period, a key factor of our assessment is the impact that COVID-19 has had and is continuing to have on energy consumption.

While movements in energy consumption exist for different customer groups (for example, increases in residential energy consumption as more people have been working from home), most distributors across the National Electricity Market are forecasting energy consumption that returns to historical trend at the aggregate level. However, Victoria has been exposed to more prolonged and significant impacts as a result of COVID-19, and these ongoing impacts are present in the consumption forecasts for Victoria.

United Energy's forecast of energy consumption is broadly in line with recent trends and we consider that the forecast is reasonable. Prior to COVID-19, United Energy's energy consumption was declining modestly. Impacts from extended lock-down periods and changes in work and social patterns in have offset each other. United Energy expects consumption to remain on this trend in 2021–22.

Under/over-recovered revenues

Energy consumption fluctuates from period-to-period due to factors such as weather, increased uptake of solar PV, or, in recent times, in response to a pandemic. As a result distributors recover more or less than the allowable revenue we set.

Actual revenue may also vary from allowed revenues because transmission costs and jurisdictional scheme amounts the distributor recovers through prices may be different from the actual payments.

To correct or 'true-up' for these variations in revenue, adjustments are made to allowable revenues for the upcoming period.

The impact of COVID-19 was a major factor in 2020 but its impacts varied across different customer groups, and different Victorian networks. Some distributors recovered less than their allowed revenue leading to increases in allowed revenues for 2021–22 to recover these amounts. For some distributors, the under-recoveries were offset by other over-recoveries of revenue. Others experienced over-recoveries in revenue in 2020 which will be passed back to consumers in 2021–22.

The adjustments made to 2021–22 revenues incorporate under/over-recovered revenues from 2019, 2020, and estimates for the HY21 periods, as well as balances carried forward from the 2018 period. For United Energy, this has resulted in an overall +$11 million (or +1.83%) adjustment to 2021–22 revenues across all components.

2021–26 distribution determination

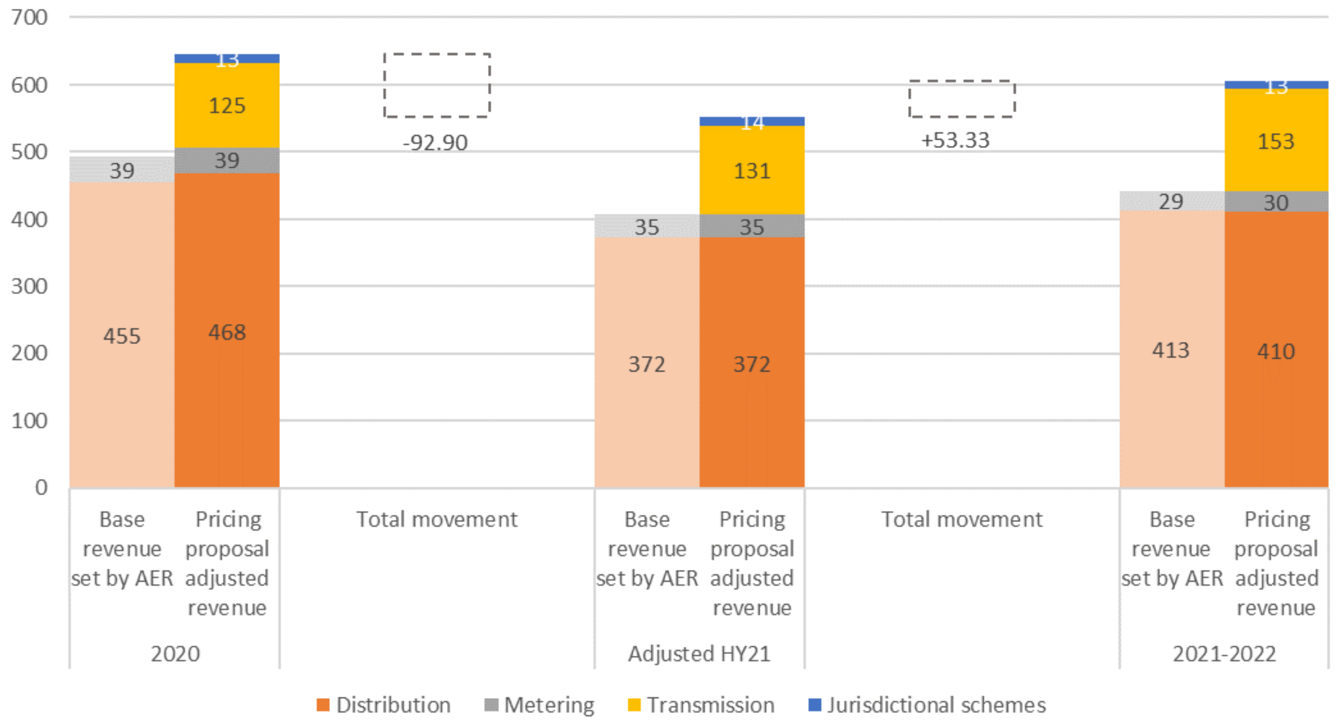
On 30 April, we published our final decisions on the Victorian networks' distribution revenue determinations for the 2021–26 regulatory control period, commencing 1 July 2021. Previously, the Victorian distributors' regulatory periods were on a calendar year basis. The 2016–20 regulatory control period was extended by 6 months (1 January to 30 June 2021, i.e. HY21) to transition the Victorian networks to financial years in line with the rest of the National Electricity Market.

In extending the 2016–20 regulatory control period, price decreases were delivered to customers on 1 January 2021. These decreases reflected a lower rate of return that would have otherwise been in place on 1 January. The remainder of our regulatory determination was set on 30 April 2021, and is reflected in prices to be applied from 1 July 2021. For the HY21 period adjustments that would usually have applied through annual pricing proposals, such as those for over/under-recoveries, were deferred until the 2021–22 period. This has added to the HY21 period being lower than prices in 2020 and 2021–22.

The chart below provides the revenue amounts allowed to be recovered by United Energy in the 2020, HY21, and 2021–22 periods, and relevant revenue movements. The chart also shows the distribution (light orange) and metering (light grey) revenues set for the corresponding periods in our determinations, before any annual adjustments through pricing proposals are applied.

In the 2021–26 determination, we provided commentary on how these movements in allowed revenue would impact customer's bills. To do this, forecast consumption was used to estimate residential and small business impacts. The forecast consumption used to calculate these bill impacts was provided prior to the effects of COVID-19. For this reason, the bill impacts provided in the 2021–26 determination differ to the movements expected as a result of United Energy's pricing proposal. These movements incorporate consumption forecasts that reflect the impact of COVID-19, as well as more up-to-date information.

Figure 3 Revenue movements



Source: AER Analysis; United Energy's 2020, HY21 and 2021–22 pricing proposals.
Note: Transmission and jurisdictional scheme amounts are passed through by United Energy to the customer. These revenues are not set through United Energy's determinations.

The annual pricing process and the AER's role

On 21 May 2021, United Energy submitted to the AER for approval its electricity network pricing proposal for the period 1 July 2021 to 30 June 2022. United Energy provided a revised and final submission on 8 June 2021 in response to AER queries.

In making this decision, the AER has considered United Energy's final pricing proposal and is satisfied that it complies with the relevant principles set out in section 6.18 of the National Electricity Rules (NER). The AER is also satisfied that the proposal complies with the 2021–26 distribution determination and approved Tariff Structure Statement.

The AER has also considered all forecasts provided within the submission, particularly those regarding energy consumption. The AER also confirmed that United Energy has used correct inputs, adhered to the price control formulae set in the 2021–26 distribution determination, and adhered to expectations and policies set out in its applicable Tariff Structure Statement.

There are three major components of a typical electricity energy bill: wholesale costs (covering electricity being generated), network charges (paying for the reliable delivery of energy via power lines), and a retail margin (covering customer servicing, acquisition and retention costs and other related services).

Network charges (or tariffs) are also comprised of three components:

- Distribution charges to recover the distributor's own allowed revenues as determined by the AER. These allowed revenues are set to allow the distributor to recover the costs of delivering reliable and safe electricity to customers.
- Transmission charges (or designated pricing proposal charges) to recover revenues on behalf of the transmission network the distributor is serviced by as well as other transmission related services.
- Government scheme charges (or jurisdictional scheme charges) to recover amounts relating to schemes imposed by State or Territory Governments, or similar entities, such as premium feed-in tariff schemes.

The AER approves the network charge component of an energy bill, which accounts for approximately 43% of the total residential retail bill. Distribution costs typically account for the bulk of this network charge.

Each period electricity distributors, such as United Energy, are required to submit an annual pricing proposal to the AER, outlining proposed prices to take effect from the commencement of the next regulatory period. We must approve the proposals if we are satisfied they comply with the requirements set out in the NER (including complying with any applicable distribution determination) and if all forecasts associated with the proposals are reasonable. Where a proposal does not meet these requirements, we seek amendments to correct the deficiencies.

The revenue that the distributor proposes to recover must be compliant with the NER and its revenue determination. The distribution revenue amounts set through our revenue determination are adjusted on an annual basis for a variety of factors such as performance against incentive schemes and correcting for prior period under- or over-recoveries.

In proposing prices to recover this adjusted revenue, the structure of the tariffs set out in each annual pricing proposal must match those approved by us in the applicable Tariff Structure Statement. The proposed tariffs must also comply with certain requirements in the NER. Within these parameters, the distributor has discretion to propose prices that are consistent with its revenue cap. To demonstrate compliance with this revenue cap, the distributor is required to provide a forecast of energy consumption for the coming period.

In addition to proposing prices that are consistent with these adjusted distribution revenues, the electricity distributor also sets out separate prices for the recovery of applicable transmission and jurisdictional scheme costs. These distribution, transmission and jurisdictional scheme components are summed together to generate the proposed network prices.

We have assessed United Energy's 2021–22 pricing proposal as being compliant with the NER and its revenue determination. We have further assessed the forecasts embedded in its proposal as reasonable. On this basis, we have approved the prices contained United Energy's 2021–22 proposal.