

November 2020

## Statement of reasons: Powercor Distribution Annual Pricing Proposal

On 2 November 2020, Powercor submitted to the AER its final electricity distribution network pricing proposal for the half-year period 1 January 2021 to 30 June 2021 (HY 2021).<sup>1</sup>

The AER has considered Powercor's final pricing proposal and is satisfied that it complies with the relevant principles and formulae set out in section 6.18 of the National Electricity Rules. The AER is also satisfied that the proposal complies with the applicable Tariff Structure Statement.

In reviewing Powercor's proposal, the AER has considered the consumption forecasts for the HY 2021 period. The AER also confirmed that Powercor has used correct inputs, adhered to the price control formulae set in the HY 2021 determination, and adhered to expectations and policies set out in the applicable tariff structure statement.

Having considered Powercor's final pricing proposal, the AER approves these tariffs for commencement on 1 January 2021. The approved HY 2021 distribution tariffs for Powercor are set out on our website.

### *Background*

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

Energy bills also include components for Commonwealth and state or territory government-based environmental programs such as those aimed at increasing renewable electricity generation.

The AER approves the network charge component of an energy bill, which accounts for approximately 38% of the total residential retail bill in Victoria. Distribution costs account for the bulk of this network charge.

Each year electricity distributors, such as Powercor, are required to submit an annual pricing proposal to the AER, outlining proposed prices to take effect from the commencement of the next regulatory year.

We must approve the proposals if we are satisfied they comply with the requirements set out in the National Electricity Rules (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.

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<sup>1</sup> In April 2019, the Victorian Government decided to move the annual network price changes for Victoria from a calendar year to financial year basis. For the new regulatory period to commence at the beginning of a financial year (i.e 1 July 2021), the current regulatory period 2016-2020 finishing on 31 December 2020 had to be extended by six months.

Due to unforeseen delays in the passage of the legislation extending the 2016-20 regulatory control period by six months, Powercor prepared its draft proposal – submitted on 13 October 2020 – using information provided by the AER. Information on our approach to annual pricing for 2021, and information provided to Powercor prior to the six-month extension variation decision can be found on the AER website at <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/powercor-determination-2021-26/update>.

The revenue that the distributor proposes to recover must be compliant with the NER and its revenue determination. While the distribution revenue amounts set through our revenue determination are typically adjusted on an annual basis for a variety of factors such as performance against incentive schemes and correcting for prior year under- or over-recoveries, this is not the case for HY 2021 as simplified control mechanisms have been applied for this six-month extension period.<sup>2</sup>

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 year.

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 Powercor's HY 2021 final pricing proposal as being compliant with the NER and its revenue determination. We have further assessed the forecasts embedded in its proposal as reasonable (see below for more detail). On this basis, we have approved the prices contained Powercor's HY 2021 final proposal.

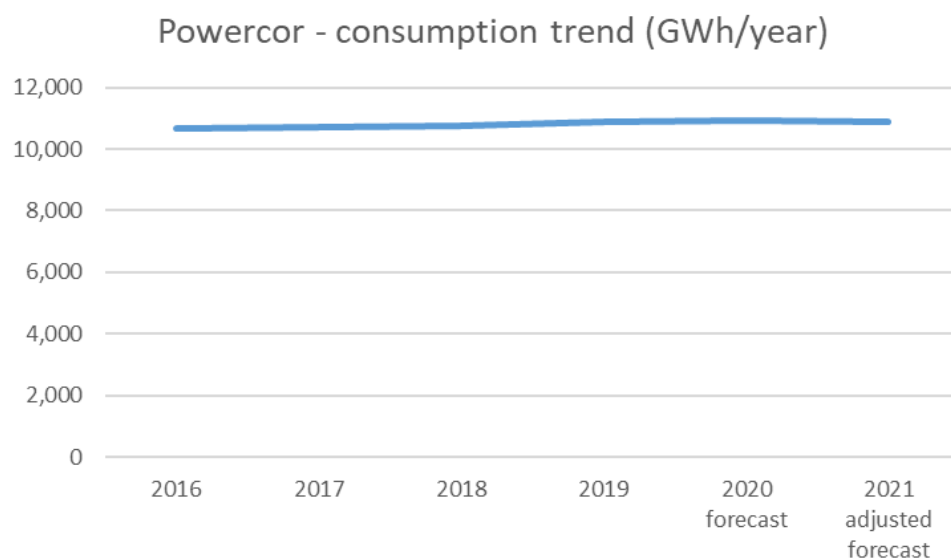
### *Consumption forecasts*

Given the impact of COVID-19 on energy consumption, the AER has paid particularly close attention to the consumption forecasts embedded in the distributors' pricing proposals. Powercor has forecast consumption for HY 2021 using 2019 as a base year, with adjustments proportionate to forecast customer growth. The forecast customer growth rates used consider historic trends as well as COVID-19 impacts. Once we adjust the 2021 forecast consumption to reflect a full year, we can see that the forecast is consistent with forecasts provided by Powercor in recent years (prior to COVID-19). This can be seen in Figure 1 below.

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<sup>2</sup> See section 2.12 and Attachment A of our October 2020 Final Decision on the Six-month extension – variation decision for Powercor, available at: <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/powercor-determination-2021-26/aer-position>. We expect to apply these adjustments instead to the 2021-22 and 2022-23 periods as set out in Attachment 16 of our September 2020 Draft Decision on Powercor's 2021-26 Distribution determination, available at: <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/powercor-determination-2021-26/draft-decision>.

**Figure 1 – Consumption trend**



Source: AER Analysis; RIN data; Powercor's 2020 and HY 2021 pricing proposals.

Note: 2020 forecasts as provided by Powercor in its pricing proposal; 2021 forecast volumes adjusted for full year.

Further analysis of the forecasts compared to metered consumption<sup>3</sup> in 2020 to date supports the consumption forecasts provided by Powercor. A general assumption has been made across all Victorian distributors that the impacts of COVID on energy consumption will mostly be reversed by, or during, HY 2021.

Based on the information provided by Powercor in response to our queries, and our analysis of consumption forecasts and trends, we consider that the consumption forecasts provided by Powercor are reasonable.

#### *Further information on estimated network cost movements*

As a result of our decision, we expect the network component of the typical bill for Powercor customers to be \$35 lower for households and \$18 lower for small business over the first half of 2021.<sup>4</sup> These estimated network cost movements include both network tariffs and metering charges.<sup>5</sup> Actual bill impacts experienced by consumers will likely vary from these estimates – for example, because customers are on different tariffs or consume different amounts of energy from our baseline assumptions, or because retailers will ultimately determine how these underlying network tariffs are reflected in the retail prices offered to customers.

<sup>3</sup> The metered consumption available covers the vast bulk of electricity connections using advanced metering infrastructure. Some older metered connections and unmetered connections are not included, and assumptions have been made to adjust for these factors when comparing this data to forecast consumption for HY 2021.

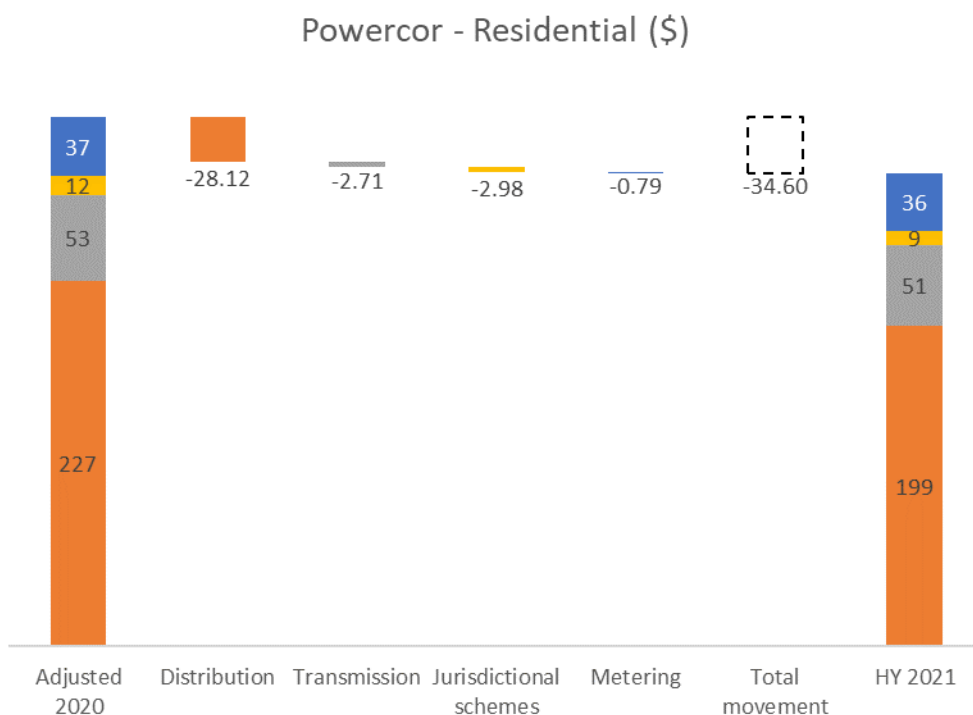
<sup>4</sup> We have made adjustments to 2020 prices where relevant (e.g. adjusting fixed annual charges) to enable comparison of these prices with those for HY 2021.

<sup>5</sup> Network cost movements reflect the movements in prices for the most common residential and small business tariffs from the previous period. A consumption profile is calculated using the most recent actual regulatory information notice (RIN) data. This consumption profile is used to calculate an estimated network cost for each year (or for 6 months, in the case of HY 2021).

To improve transparency over the drivers of movements in network tariffs, the charts below depict the estimated network cost movements attributable to the various components of network tariffs and metering charges. To derive these cost movements, we use consumption profiles from the most recent regulatory information notice (RIN) data.

The distribution components of network tariffs are decreasing, primarily as a result of our decision on the revenues distributors are entitled to recover over this six-month period. The orange box labelled ‘distribution’ reflects the estimated change in the distribution component of the approved network tariffs between 2020 and HY 2021 (when measured on a comparable basis).

**Figure 2 Residential network cost movements**



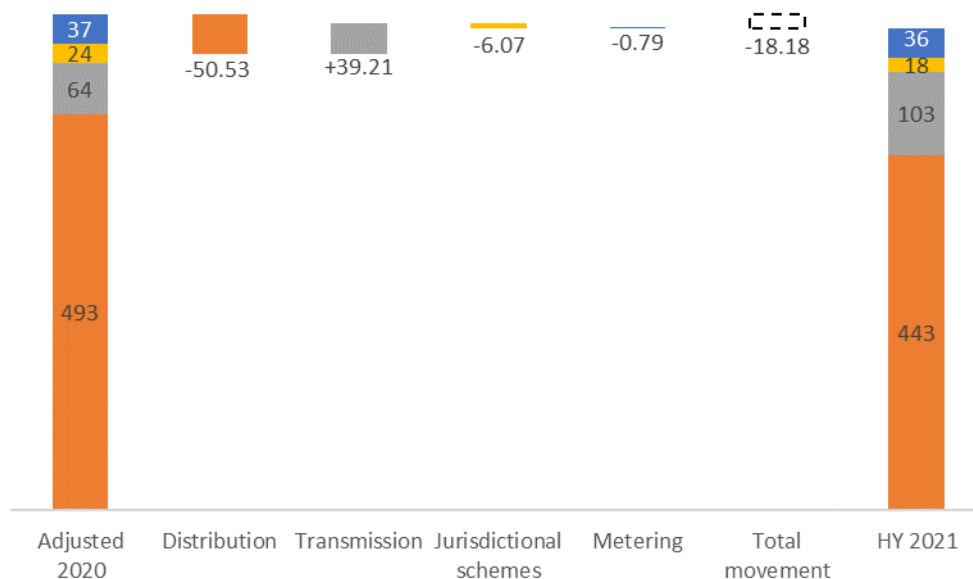
Source: AER Analysis; RIN data; Powercor’s 2020 and HY 2021 pricing proposals.

Note: The above analysis assumes electricity usage of 2463 kWh over a 6-month period. This is based on the most recent data for residential electricity usage and customer numbers reported in Powercor’s 2019 economic benchmarking RIN. The 2020 figures have been adjusted to allow for presentation on a comparable basis with the HY 2021 figures.

We estimate that the typical network cost for a residential customer will decline by around \$35 in HY 2021. Decreases are expected across all components of residential network costs.

**Figure 3 Small business network cost movements**

Powercor - Small business (\$)



Source: AER Analysis; RIN data; Powercor's 2020 and HY 2021 pricing proposals.

Note: The above analysis assumes electricity usage of 5021 kWh over a 6-month period. This is based on the most recent data for non-residential non-demand electricity usage and customer numbers reported in Powercor's 2019 economic benchmarking RIN. The 2020 figures have been adjusted to allow for presentation on a comparable basis with the HY 2021 figures.

We estimate that the typical network cost for a small business customer will decline by around \$18 in HY 2021. An increase in transmission charges has been offset by a decrease in distribution, jurisdictional scheme and metering charges.

The approved network tariffs will apply for the period 1 January to 30 June 2021. New network tariffs will be set in June 2021 to apply to the period from 1 July 2021 to 30 June 2022. These network tariffs will reflect the outcome of our decision on Powercor's revenue determination for the 2021-26 regulatory control period, adjustments for performance against incentive schemes and to reflect previous year under- or over-recoveries, and other factors such as transmission and jurisdictional scheme costs.