

May 2021

Statement of reasons: Essential Energy’s Annual Pricing Proposal

The AER approves Essential Energy’s final pricing proposal and the tariffs contained within for commencement on 1 July 2021. The approved 2021/22 tariffs for Essential Energy are set out on [our website](#).

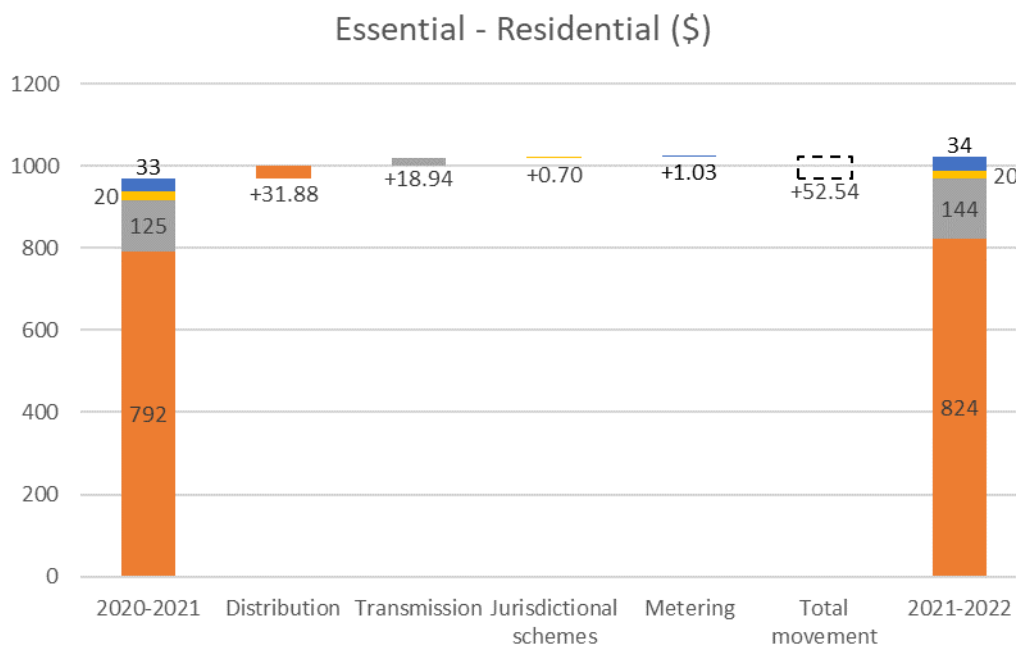
Estimated network cost movements

We estimate the network component of the typical bill for Essential Energy customers to be \$53 higher for households and \$152 higher for small business in the 2021/22 year.

These estimated network cost movements include both network tariffs and metering charges.¹ 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 assumptions, or because retailers will ultimately determine how these underlying network tariffs are reflected in the retail prices offered to customers.

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

Figure 1 Residential network cost movements



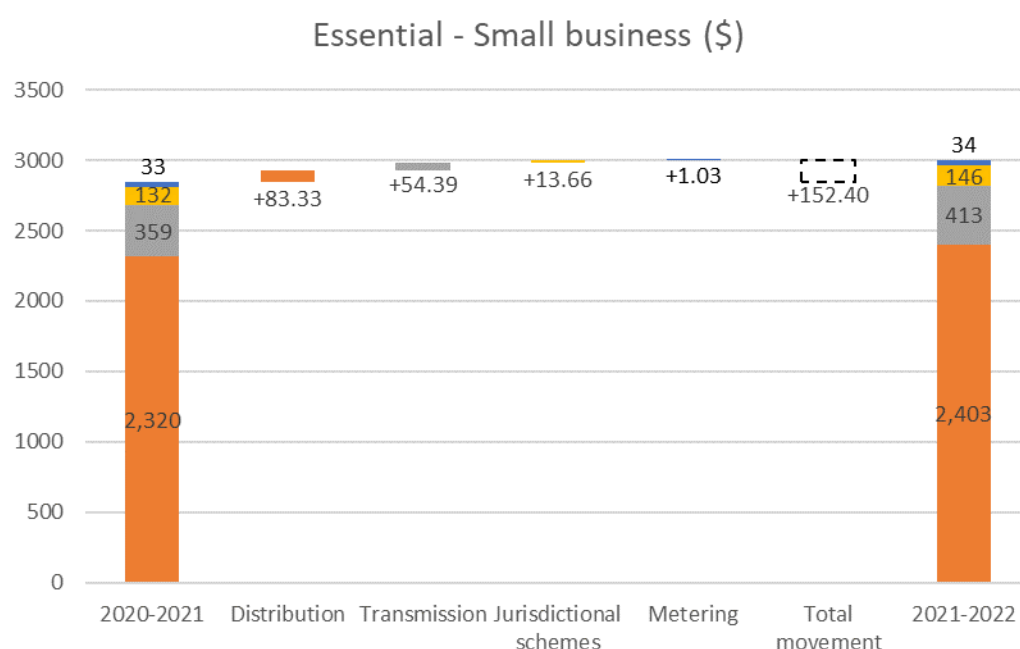
Source: AER Analysis; RIN data; Essential Energy’s 2020/21 and 2021/22 pricing proposals.

Note: The above analysis assumes electricity usage of 6,014kWh. This is based on the most recent data for residential electricity usage and customer numbers reported in Essential Energy’s 2019/20 economic benchmarking RIN.

¹ 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. Small business consumption profiles are based on non-residential non-demand customer data, being the most representative data available.

The distribution component of network tariffs is increasing, primarily as a result of under-recovered revenue in previous years now being recovered by Essential Energy. This is in addition to increases in the transmission component as a result of increasing transmission charges incurred by Essential Energy.

Figure 2 Small business network cost movements



Source: AER Analysis; RIN data; Essential Energy's 2020/21 and 2021/22 pricing proposals.

Note: The above analysis assumes electricity usage of 17,266kWh. This is based on the most recent data for non-residential non-demand electricity usage and customer numbers reported in Essential Energy's 2019/20 economic benchmarking RIN.

The price movements provided are for the main flat rate tariffs for residential and small business customers. Essential Energy provides a range of tariffs for each type of customer and the expected movements can vary across different tariffs. This reflects the discretion Essential Energy has in applying price movements across tariffs in line with the 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 price movements are small, this can mean some tariffs are increasing while others are decreasing.

Consumption forecasts

Given the impact of COVID-19 on energy consumption, the AER has paid close attention to the consumption forecasts embedded in the distributors' pricing proposals. 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 are forecasting energy consumption that returns to trend at the aggregate level. This demonstrates that different movements in different customer groups offset each other, as well as a return to 'normal' after the peak impacts of COVID-19 in 2020.

Essential Energy has forecast energy consumption that reflects a lower increasing trend as a result of cooler summers being expected in coming years and decreases in average usage per customer. Essential Energy has noted this decreasing average usage is driven by consistent monthly growth in new solar connections and increasing capacity of solar systems being installed by customers. Based on the information provided by Essential Energy in response to our queries, and our analysis of consumption forecasts and trends, we consider that the consumption forecasts provided by Essential Energy are reasonable.

Background

On 31 March 2021, Essential Energy submitted to the AER for approval its electricity network pricing proposal for the period 1 July 2021 to 30 June 2022. Essential Energy provided a revised and final submission on 30 April 2021 in response to AER queries.

In making this decision, the AER has considered Essential 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 2019–24 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 Essential Energy has used correct inputs, adhered to the price control formulae set in the 2019–24 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 year electricity distributors, such as Essential 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 year. 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 year 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 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 Essential 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 Essential Energy's 2021/22 proposal.