Price Path

Negotiating Position for the Customer Forum

Overview of Position

Once allowed revenues are decided by the AER, there is some flexibility in how the revenue is recovered over the period which affects the profile of price changes that customers see. The National Electricity Rules require that there is a close match between the “smoothed” and required revenue in the final year of the regulatory period, to minimise price impacts between periods. The question posed to the Customer Forum is then the following:

What is the desired price profile for consumers?

The rest of this note outlines three indicative price paths. As part of the negotiating process, we are asking to Customer Forum whether customers prefer either:

– An immediate sharp reduction in real bills in 2021, followed by a gradual annual increase to 2025 (default as per the AER’s model); or
– An initial moderate reduction in real bills in 2021, followed by a gradual annual decrease to 2025; or
– A gradual reduction in real bills each year until 2025.

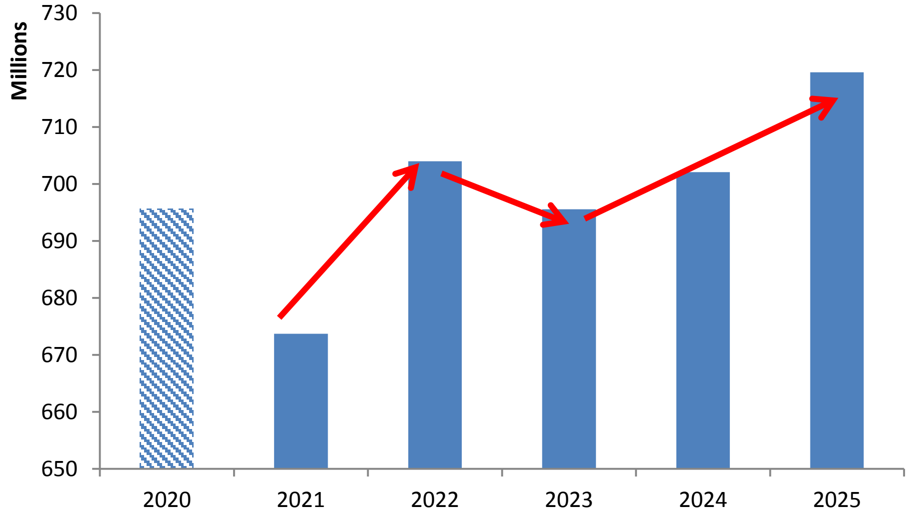
The nominal bill impact of these options i.e. what customers will actually see, is provided in the Appendix.

The magnitude of the bill changes that AusNet Services is able to propose will be confirmed during the second round of negotiations in early 2019, and will depend on a number of factors including the outcome of the AER’s Rate of Return Guideline and the Tax Review.

Background

The Rules call for revenue “smoothing” of maximum allowed revenue in order to minimise the price volatility for consumers. Figure 1 below details AusNet Services’ unsmoothed revenue requirement.

Figure 1: Unsmoothed Revenue Requirement (real $2020)



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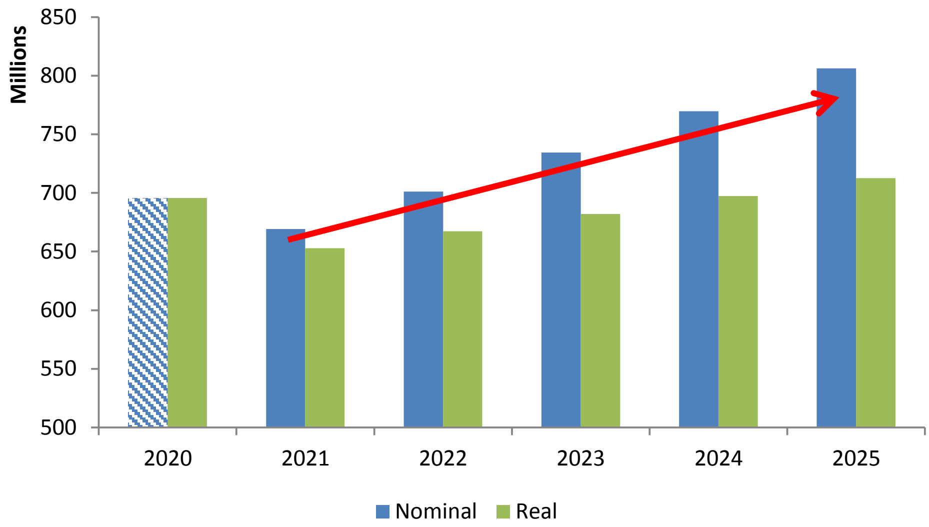
As can be seen in Figure 1, the movement between each years' revenue requirement is relatively sharp, and will result in large differences in network bills for consumers each year over the regulatory period. Smoothing the revenue requirement over the period ensures there are no big shocks to customers' bills within periods. The smoothed revenue requirement can be seen below in Figure 2.

Figure 2: Smoothed Revenue Requirement



Under the Rules, revenues are smoothed so that the final year of smoothed revenue is as close as possible to required revenue in the final year of the period. There are three options that AusNet Services is considering for the price path, which have differing effects on consumers over time, however, all will result in the same amount of revenue being collected, in real terms. In Figure 2 above, the blue columns follow the nominal price path with a 16% increases in prices, while the green columns follow the real price path which accounts for increases in inflation each year over the period and results in a much softer increase in prices.

The effect felt by customers is better reflected in revenue per customer number (that is, bills), as costs are recovered across all consumers. Annual revenue per customer is detailed in the figure below.

Figure 3: Unsmoothed Revenue per Customer

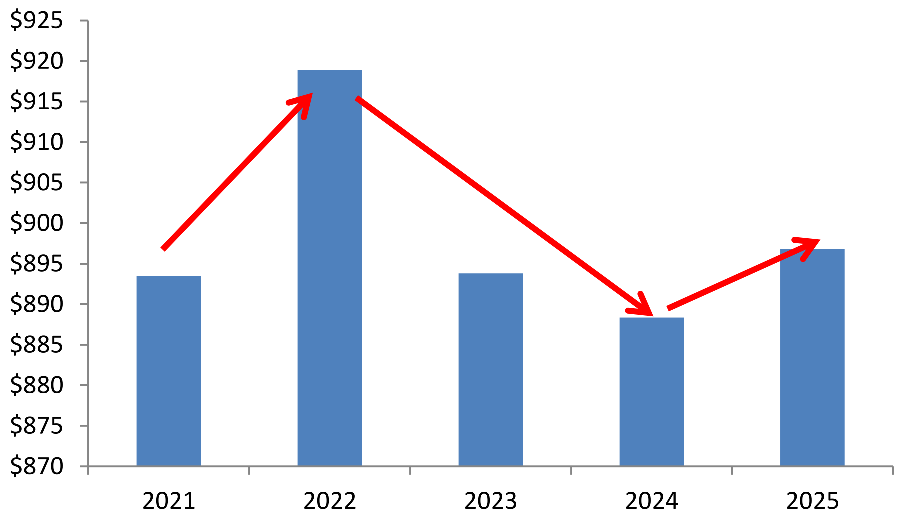


Figure 3 also highlights the need for revenue smoothing – between 2021 and 2022 the revenue recovered per customer increases by $25, which can be a large increase in bills for only one year's difference.

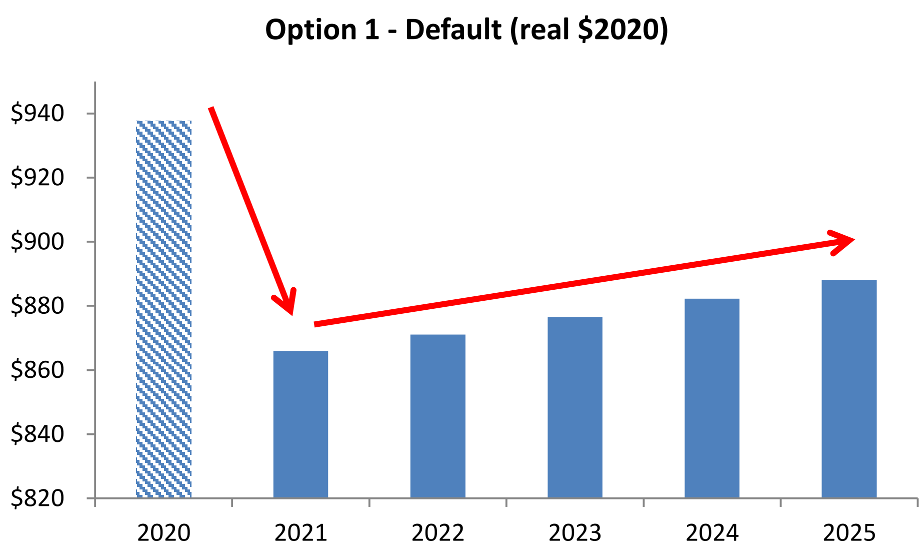
This Note presents revenue per customer as an average across all customers. In reality, the average residential bill would be significantly below this, while the bill for large business customers would be substantially above this. These differing impacts are shown in the Overview paper. It is the direction and indicative magnitude of movements in the price path that is relevant for the Customer Forum to form a position on Price Path.

Possible Customer Impacts

Three options for AusNet Services to set the price path over the regulatory period are shown below. These approaches are detailed in Figures 4 to 6 below.

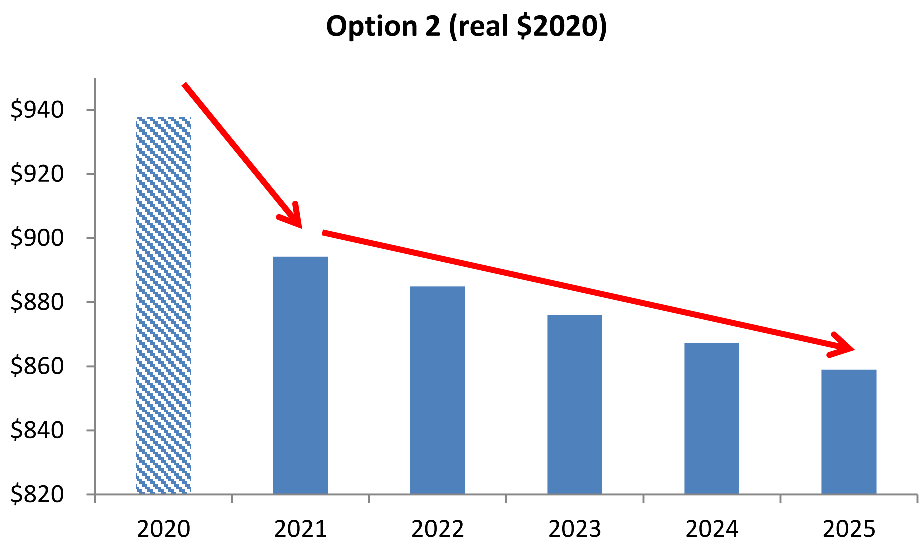
The prices are denoted as revenue or customer (average annual bill per customer) and involve real changes (taking inflation changes into account).

Figure 4: Default, Revenue-Smoothed



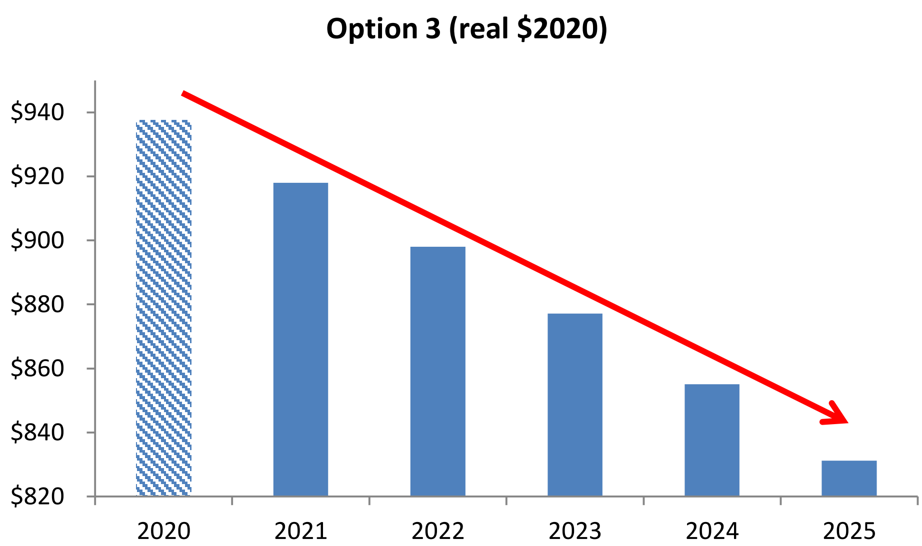
The above figure details the default revenue-smoothed position, and involves a 7.6% real decrease in prices between 2020 and 2021 with a gradual increase in prices to the end of the period.

Figure 5: Option 2 - Sharp Decrease then Gradual Decrease



This option results in a 4.6% real decrease between 2020 and 2021, with a gradual decrease following to the end of the period. The decrease is due to a realignment of revenue recovery compared to the default revenue smoothing case presented in Figure 5 above.

Figure 6: Option 3 - Gradual Decrease



The final option presented involves the gradual decrease across the entire period without a sharp change in prices between 2020 and 2021. This option involves a larger decrease in prices over the period compared to the previous option. In real 2025 dollar terms, the average bill experienced with this option will be about $830, compared to about $860 in Option 2.

These options are presented in nominal terms in the appendix of this note. It is important to remember that while the nominal prices are increasing, these increases are less than inflation, which results in a real decrease in prices over the period in all of the options presented.

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Key Assumptions

It is important to remember that updates to annual revenues will impact the actual price path. These updates include updating for actual inflation, operational incentive payments, updating cost of debt, and contingent projects that are approved by the AER.

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Appendix

The graphs presented in the main body of the note are recreated in nominal terms below.

Consumers are more likely to perceive price changes in nominal terms; however it is real changes that they will actually experience. The two options presented are recreated in nominal terms below, for the sake of transparency.

The two alternative options to simple revenue smoothing presented are much flatter than the default option, as they even further smooth the revenue recovered from consumers over the period. In nominal terms, by 2025 the default option has an average bill of more than $1,000, whereas with Option 2 the average bill increases to not quite $950.

Figure 7: Default Option 1 Nominal

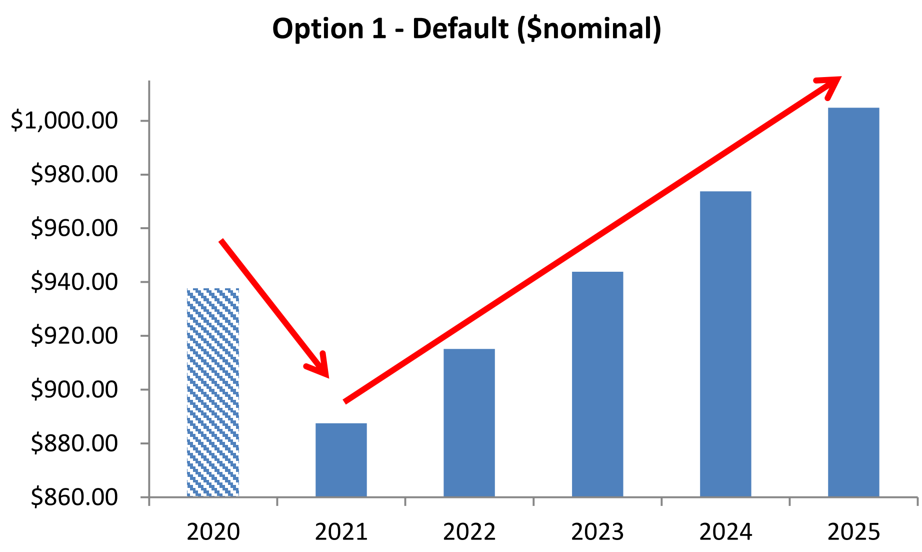

Figure 8: Option 2 Nominal

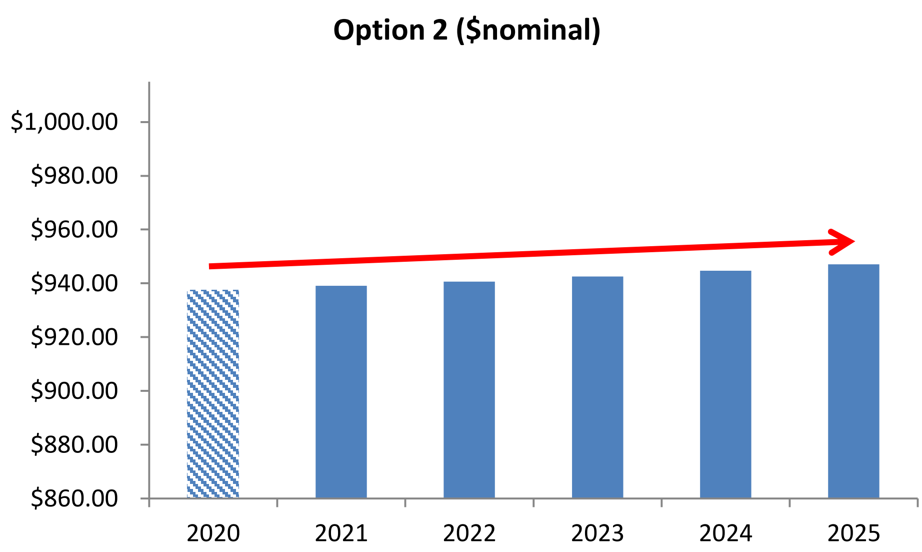

Figure 9: Option 3 Nominal