

# AEMC 2014 ELECTRICITY PRICE TRENDS REPORT

THIS REPORT LOOKS AT THE FACTORS DRIVING RESIDENTIAL ELECTRICITY PRICES OVER THE NEXT THREE YEARS TO 30 JUNE 2017

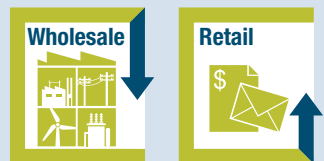
**South Australia** market offer prices are expected to decrease by around 3.9% in 2014/15 and 3.5% in 2015/16, before increasing by 0.2% in 2016/17

## WHAT ARE THE COMPONENTS THAT MAKE UP A TYPICAL SOUTH AUSTRALIAN ELECTRICITY BILL?



### Competitive markets

Wholesale prices are falling and retail competition is effective



- Competitive market costs decrease, on average, by 4.7% a year to 2016/17
- This reflects lower wholesale prices due to a growing oversupply of generation capacity as a result of falling energy consumption and growth in generation subsidised under the Renewable Energy Target
- The expected fall in wholesale prices may reverse in future if these conditions lead to thermal generators exiting the market
- By shopping around for a better deal, South Australia consumers may have saved around 10% in 2013/14

### Regulated networks

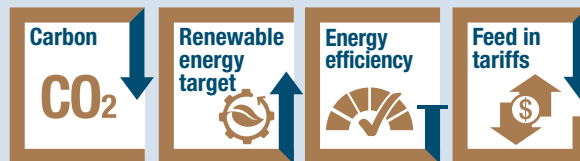
Pressure on the cost of poles and wires is moderating



- Regulated network prices are expected to rise by an average 3.5% per year to 2016/17
- The regulated rate of return, which drove previous network cost increases, is falling with changed financial market conditions. This effect may be offset by proposals to increase expenditure to replace ageing assets and upgrade the networks
- New rules made by the AEMC are being applied in South Australia which better equip the regulator to set efficient network revenues, so people don't pay more than necessary
- Distribution network prices for 2015/16 and 2016/17 will depend on the regulator's final determination in October 2015 on proposed network revenues

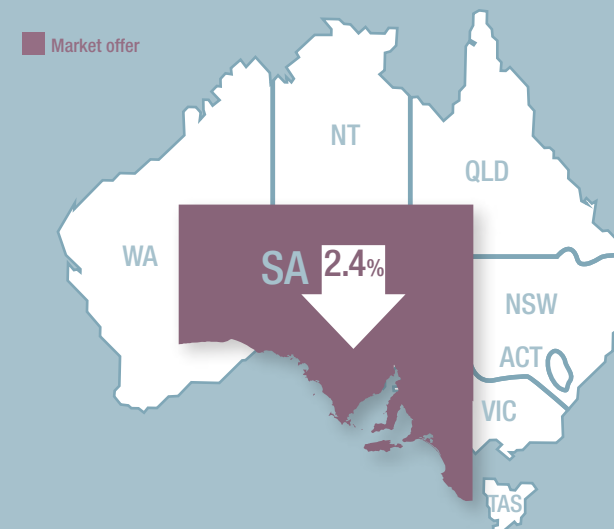
### Environmental policies

The cost of the Renewable Energy Target continues to impact prices

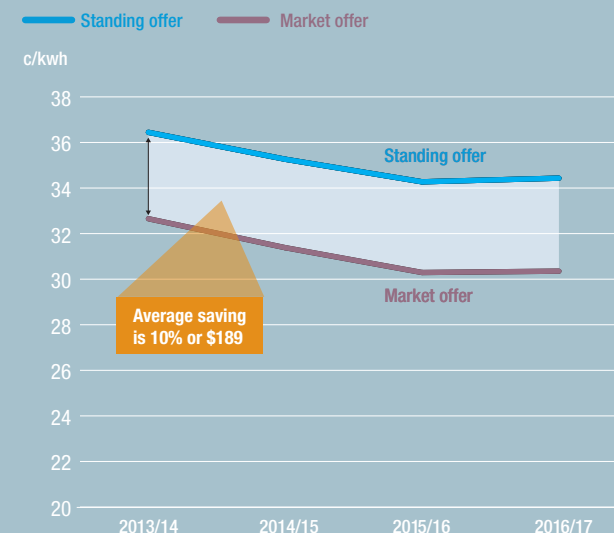


- The fall in prices in South Australia in 2014/15 is driven mainly by removal of the carbon price
- Costs associated with the Renewable Energy Target are expected to rise by an average 4.8% per year to 2016/17 and will represent around 5% of a consumer's bill in that year
- Costs of other environmental policies, such as the feed-in tariff schemes and the Residential Energy Efficiency Scheme, are expected to be stable to 2016/17

## WHAT WILL EXPECTED AVERAGE ANNUAL PRICE TRENDS BE BETWEEN JULY 2014-17?



## SWITCH AND SAVE: STANDING VS MARKET OFFER IN SA



For further details including methodology, visit [www.aemc.gov.au](http://www.aemc.gov.au)

# AUSTRALIAN ENERGY MARKET COMMISSION

## CHANGING THE ENERGY LANDSCAPE: NEW RULES FOR NETWORKS

AN INCENTIVE-BASED REGULATORY FRAMEWORK

**NOVEMBER 2012:**

Economic Regulation of Network Service Providers rule change

### OUTCOMES OF THE 2012 RULE CHANGES

#### Setting revenue allowances for regulated networks

Regulation based on business efficiency means consumers don't pay any more than necessary for the reliable supply of electricity and gas.



**NOVEMBER 2014:**

Distribution Network Pricing Arrangements rule change

### OUTCOMES OF THE 2014 RULE CHANGES

#### Structuring prices to empower consumers

Making network prices reflect the cost of providing network services to individual consumers means everyone can make informed decisions about how they use electricity. These rules cover how much individual households will pay for their network services.



**Allowed revenues for network businesses are now set using the expenditure required by prudent, efficient operators as a benchmark**

Companies have incentives to beat the benchmarks so they can keep some of their savings and pass the rest on to customers

By July 2017 the prices we pay will reflect the different ways we use electricity and the costs of providing it

**The rules put consumers in the driving seat**

The way we pay for power has to keep pace with our modern lifestyle. When prices reflect how much it costs to use different appliances at different times, consumers are able to make more informed decisions



AEMC rules are used by the Australian Energy Regulator (AER) to set the revenues that network businesses can recover as well as the maximum prices they can charge



The AER is able to review the efficiency of past capital expenditure overspends when assessing future revenue proposals



The AER works out revenues based on analysis of efficient costs including operating and capital expenditure, return on capital, depreciation, and tax liabilities



The AER has to release reports on network business performance to compare business performance across jurisdictions and over time



The rules include clear instructions for networks on the requirements to apply when determining how to structure network prices



There is more consumer consultation on how network prices are structured



Earlier notification of network prices allow retailers and consumers to better prepare for price changes



The right information on costs will help people choose energy services that are right for them – whatever technology changes lie ahead

NOVEMBER 2012

2013

27 NOVEMBER 2014

27 NOVEMBER 2014

2015

2017

AEMC makes new rules on setting network revenue allowances

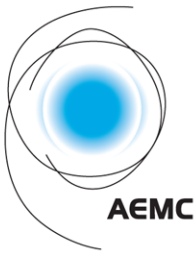
AER develops guidelines in response to the new rules and conducts public consultation under its Better Regulation Program

AER releases first draft revenue determinations under the new rules and guidelines

AEMC makes rules requiring cost reflective pricing for individual consumers

Network companies consult consumers and retailers on new tariffs and submit draft proposals to AER mid-year

Cost-reflective prices phased in no later than mid-year



# NEWS

## Electricity prices falling in South Australia over the next two years

**The Australian Energy Market Commission (AEMC) today released its 2014 Residential Electricity Price Trends report, which shows prices in South Australia are expected to fall next year and remain flat in 2016/17.**

The report analyses trends in the competitive market sectors of the electricity industry; the regulated networks sector; and resulting from government environmental policies. The factors driving each of the three are different, so understanding price trends involves looking into each individually.

AEMC Chairman John Pierce said the factors which had previously led to significant price growth in South Australia were now moderating.

“The cost of supplying electricity has fallen by around 3.9 per cent this year mainly due to the removal of the carbon price, although this is partly offset by increases in other supply chain components. Prices are expected to decrease a further 3.5 per cent in 2015/16, before remaining steady in 2016/17,” Mr Pierce said.

He said the main factor driving prices down in South Australia was lower wholesale electricity prices resulting from an oversupply of generation capacity.

“Competitive market costs are expected to fall by an annual average 4.7 per cent in South Australia to 2016/17, driven by an oversupply of generation capacity as a result of falling electricity consumption and growth in generation subsidised under the Renewable Energy Target.

“This expected fall in wholesale prices may reverse in the future if these conditions lead to thermal generators exiting the wholesale market.”

The report also shows a moderation in network prices in South Australia which are proposed to increase at an annual average 3.5 per cent to 2016/17.

Mr Pierce said the regulated rate of return which drove previous network cost increases is falling with changed financial market conditions, and new rules made by the AEMC would be applied from mid-2015 to proposals for future revenue allowances for network businesses.

“The new rules better equip the Australian Energy Regulator to set efficient revenue allowances for network companies so people don’t pay more than necessary for the cost of maintaining and upgrading the poles and wires.

“Network prices for 2015/16 and 2016/17 will depend on the regulator’s final determination under the new rules.”

The removal of the carbon price has reduced electricity prices in 2014/15, however the cost of other environmental policies is expected to rise, including the Renewable Energy Target which is expected to make up 5 per cent of a South Australian consumer's electricity bill by 2016/17.

Mr Pierce said retail competition in South Australia meant there were a diverse range of electricity offers available to consumers with opportunities to shop around and save on a better deal.

"South Australians could save an average 10 per cent in 2013/14 by switching electricity providers to save on a better deal – or around \$189 on their annual bill.

"We would encourage consumers to take advantage of competition between service providers by shopping around and choosing a better deal to save on their bills."

The annual Residential Electricity Price Trends report is part of the AEMC's work to strengthen consumer engagement in energy markets.

The full report is available at [www.aemc.gov.au](http://www.aemc.gov.au).

#### **About the AEMC**

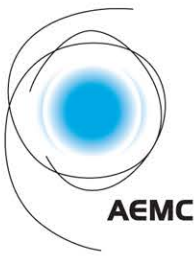
We are the independent body responsible since 2005 for providing advice to Australian governments on development of the electricity and gas sector. We make statutory energy market rules which are applied and enforced by the Australian Energy Regulator (AER).

#### **Media contacts:**

Communication Manager, **Prudence Anderson** 02 8296 7817 or 0404 821 935

Communication Specialist, **Tim O'Halloran** 0409 059 617 or 02 8296 7871

EMBARGOED 1pm AEDT, 11 December 2014



## South Australia: Household electricity price trends

South Australian residential electricity prices expected to decrease due to falling wholesale energy costs

**The 2014 Residential Electricity Price Trends report identifies factors driving electricity prices over the three years to 2016/17 in all states and territories. By providing this information at the request of the COAG Energy Council, the AEMC is seeking to strengthen consumer engagement in the market.**

The Residential Electricity Price Trends report presents expected movements in prices for a representative consumer in South Australia, using an annual consumption level that was provided to us by the South Australian Government.

- The annual consumption of the representative consumer in South Australia is assumed be 5,000 kilowatt-hours (kWh).
- Average electricity prices in this report are specific to the representative consumer and may not reflect the pricing outcomes for all residential consumers.

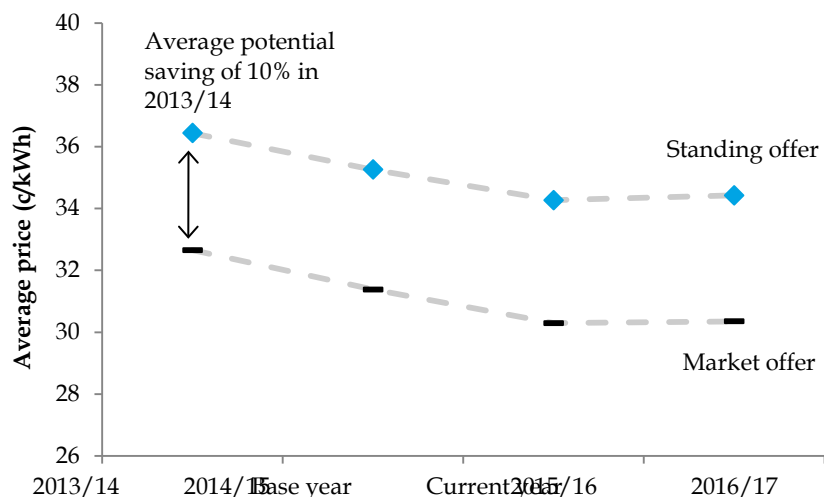
To undertake this work, we analysed trends in the competitive market sector of the industry, the regulated networks sector and the impact of government environmental policies. We report on how these trends affect overall prices paid by residential consumers, in order to identify the relative contribution to the price movements of these drivers.

### Key findings for South Australia

On average, *market offer* prices in South Australia have decreased by 3.9 per cent in 2014/15 for the representative consumer, and are expected to decrease by 3.5 per cent in 2015/16 followed by an increase of 0.2 per cent in 2016/17. This is equivalent to an annual average decrease of 2.4 per cent over the reporting period, as shown below.

Consumers may have saved around 10 per cent, or \$189, if they switched from the *standing offer* to the representative *market offer* in 2013/14. Actual savings will depend on individual circumstances, such as level of consumption. More savings are possible if consumers shop around and choose the best *market offer* to meet their needs.

Trend in South Australian *market offer* and *standing offer* price



Prices have decreased by around 4 per cent in 2014/15, mainly due to the repeal of the carbon price and lower wholesale costs

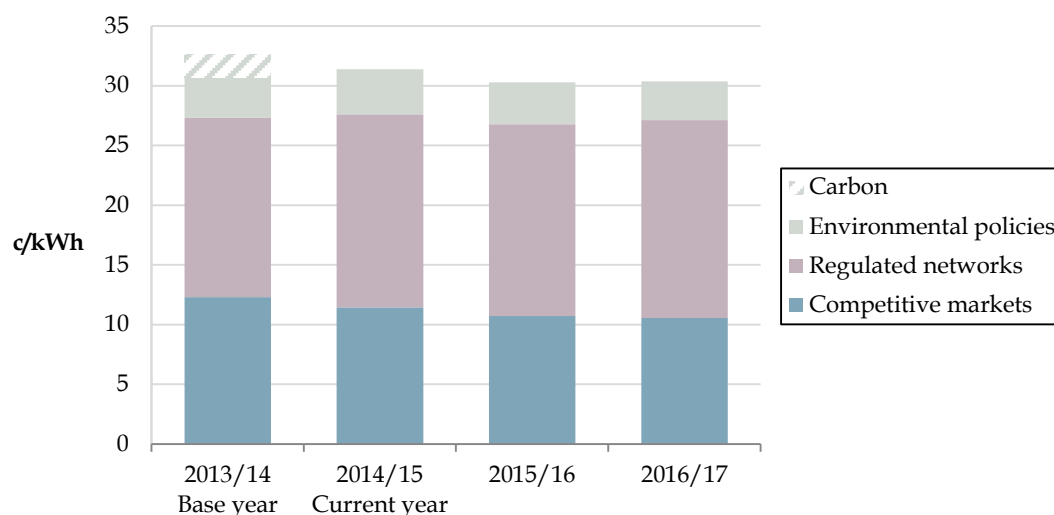
In July 2014, there were a total of 17 electricity offers available to residential consumers and the difference in the price between the highest and lowest offers was 6.85 c/kWh for the representative consumer.

### Drivers of price trends

Residential electricity prices have fallen in 2014/15 due to the repeal of the carbon pricing mechanism. Between 2014/15 and 2016/17 the price trend is being driven by decreases in wholesale energy and state feed-in tariff scheme costs.

In 2014/15, it is expected that the total electricity bill for a representative consumer in South Australia will consist of around 52 per cent regulated network prices, 36 per cent competitive market costs and 12 per cent environmental policy costs, as shown in the graph below.

**Trend in South Australian supply chain components**



### Regulated network prices

Regulated network prices consist of the costs of the transmission and distribution networks.

- In 2014/15, it is expected that transmission network prices will make up 8.7 per cent of the total bill for the representative consumer and distribution prices will make up 43 per cent.
- Regulated network prices are expected to increase at an average annual rate of 3.5 per cent between 2013/14 and 2016/17.

In November 2012, the AEMC made new rules relating to how networks are regulated by the Australian Energy Regulator. The new rules improve the capacity of the regulator to determine network prices. Under the new rules, the regulator is better equipped to develop methods and processes to achieve efficient outcomes for consumers, including how the regulated rate of return is set.

The new network rules will apply to the upcoming regulatory periods, meaning that during the three years from 2013/14 to 2016/17 the South Australian distribution network business will be subject to two different regulatory arrangements.

- The current distribution network determination applies until the end of 2014/15, after which time the 2015-20 regulatory period will commence and the new rules will apply to the 2015/16 and 2016/17 years in the report.
- The current transmission network determination, made under the previous rules, ends on 30 June 2018 and covers the full period of this year's report.

### Transmission networks

Transmission network prices are expected to increase at an average annual rate of 5.6 per cent over the reporting period.

- The AER's determination for the 2013-18 regulatory period allowed a lower regulated rate of return than the previous regulatory determination, although this is offset by higher allowed expenditure to replace and upgrade network assets.

#### *Distribution network*

Distribution network prices are expected to increase at an annual average rate of 3 per cent over the reporting period.

- SA Power Network's current regulatory determination, which was made under the now superseded regulatory framework and covers the 2010-15 period, allowed for distribution network prices to increase on average by 9.5 per cent annually due to increased network expenditure.
- Higher network expenditure was judged to be necessary to meet anticipated peak demand growth, which was occurring at the same time as a forecast decrease in energy consumption. As the expenditure to maintain the integrity of the network was applied to a smaller volume of energy sold, this resulted in an increase in distribution network prices.

For 2015/16 and 2016/17, as the regulatory determination has not yet been made we have used SA Power Network's regulatory proposal for the 2015-20 regulatory period. Actual outcomes will depend on the Australia Energy Regulator's final determination, which will be published in October 2015.

SA Power Network's has proposed a lower regulated rate of return compared to the current regulatory period which, all else equal, should put downward pressure on distribution network prices over the 2015-20 regulatory period.

#### **Competitive market costs**

Competitive market costs include the wholesale energy component and the costs associated with retailing electricity to residential consumers.

- Over the period to 2016/17, it is expected that competitive market costs will decrease at annual average rate of 4.7 per cent.
- Wholesale market modelling by Frontier Economics shows wholesale energy costs decreasing by 20 per cent over the reporting period due to a continuing oversupply of generation in the National Electricity Market.

The oversupply is being driven by falling energy consumption and additional renewable energy generation under the currently legislated Renewable Energy Target.

Low wholesale energy prices offset the costs of the Renewable Energy Target for South Australian consumers in the short term. In the medium term, wholesale prices are likely to rise in response to unprofitable generators exiting the market. If this occurs, the cost of meeting the Renewable Energy Target will become more apparent through South Australian consumers' retail bills.

The AEMC's 2014 Retail Competition Review found that there are 13 competing retailers in South Australia and 80 per cent of consumers are on a *market offer* contract. About 20 per cent of consumers changed their retailer in 2013.

#### **Environmental policy costs**

Environmental policies that apply in South Australia during our reporting period are the:

- carbon pricing mechanism;
- Renewable Energy Target;
- feed-in tariff schemes; and
- South Australian Residential Energy Efficiency Scheme.

Costs associated with the carbon pricing mechanism apply only in the base year of our reporting period (2013/14) as the policy was repealed with effect from 1 July 2014.

- In 2013/14, these costs made up around 6 per cent of the total bill for the representative consumer in South Australia.



Price drivers vary between states and territories, although there are some common underlying trends

In 2013/14, Renewable Energy Target costs made up around 4 per cent, feed-in tariff scheme costs made up 5.5 per cent and residential energy efficiency costs are less than 1 per cent of the total bill for the representative consumer.

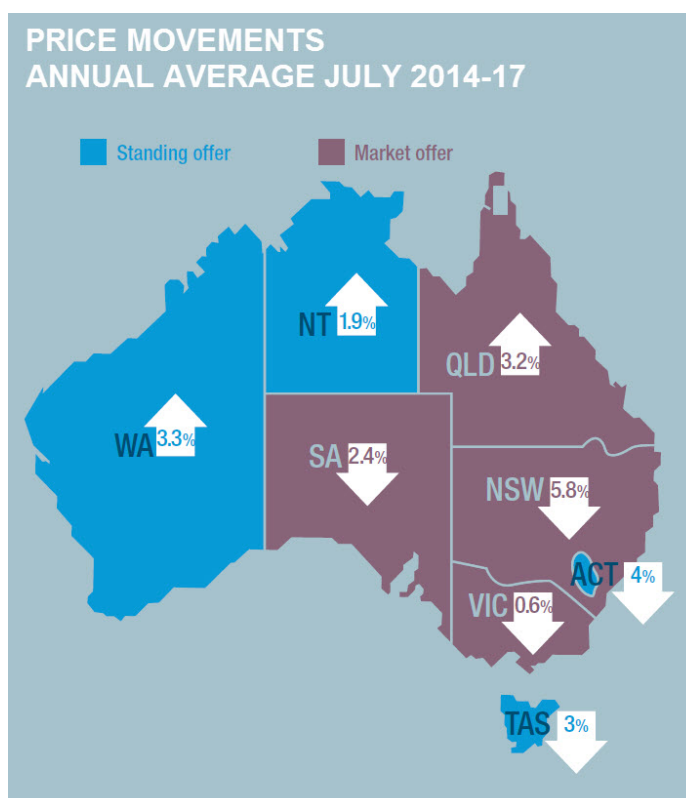
- Based on the current Renewable Energy Target legislation, scheme costs are expected to increase at an annual average rate of 4.8 per cent per year between 2013/14 and 2016/17.
- Feed-in tariff scheme costs are expected to increase in 2014/15, although decreases in the following two years result in an annual average decrease of 6.4 per cent over the reporting period.
- The Residential Energy Efficiency Scheme costs remain constant over the period.

### Jurisdictional price trends

Trends in residential electricity prices differ between states and territories. In most jurisdictions, prices are expected to have fallen in 2014/15 following the removal of the carbon pricing mechanism. The extent of this decrease varies between jurisdictions, as the savings are offset by other factors. In 2015/16 to 2016/17, price movements are mixed, reflecting different jurisdictional drivers.

On average across the three year period from 2013/14 to 2016/17, prices are relatively stable or decreasing in most jurisdictions. The exceptions to this trend are Western Australia, Queensland and the Northern Territory, where prices are expected to increase, on average, during the same period.

Our analysis of trends in *market offers* covers Queensland, New South Wales, Victoria and South Australia. In other jurisdictions, our analysis is based on trends in the regulated *standing offer* price. In jurisdictions where both *standing* and *market offers* are available, residential consumers are able to shop around for the best offer from retailers.



### Information sources

Information for this report has been sourced from jurisdictional governments and regulators. We also sourced information from the Australian Energy Regulator in relation to transmission and distribution network costs and from retailers operating in the relevant states for our analysis of *market offer* prices.

The AEMC also commissioned independent modelling of wholesale energy purchase costs, carbon pricing mechanism costs and Renewable Energy Target costs. Our



modelling was undertaken based on current knowledge and assumptions as well as existing legislation and is available on our website.

### **About the AEMC**

The Australian Energy Market Commission is the independent body responsible for providing policy advice to Australian governments on the electricity and gas sector. It makes rules that are applied and enforced by the Australian Energy Regulator.

The Residential Electricity Price Trends report is part of the AEMC's work to empower families, businesses and industry to participate confidently in all parts of the energy supply chain, where they desire to do so. It provides annual information to help consumers better understand the factors which drive residential electricity prices.

For information contact:

AEMC Chairman, **John Pierce** (02) 8296 7800  
AEMC Chief Executive, **Paul Smith** (02) 8296 7800

Media:

Communication Manager, **Prudence Anderson** 02 8296 7817 or 0404 821 935  
Communication Specialist, **Tim O'Halloran** 0409 059 617 or 02 8296 7871

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