

# 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

**Victorian** market offer prices are expected to decrease by 5.5% in 2014/15, before increasing by 2.3% in 2015/16 and 1.5% in 2016/17

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



### Competitive markets

Wholesale prices are falling and retail competition is effective



- Competitive market costs are expected to be stable, increasing on average by 1% per year to 2016/17
- Oversupply of generation capacity driven by falling demand and the Renewable Energy Target is putting downward pressure on wholesale prices in the short term
- The expected fall in wholesale prices may reverse in future if these conditions lead to thermal generators exiting the market
- There is strong retail competition in Victoria with a diverse range of tariff products on offer
- By shopping around for a better deal, Victorian consumers may have saved around 16% in 2013/14

### Regulated networks

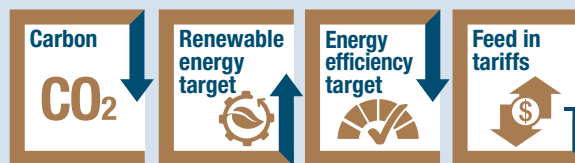
Pressure on the cost of poles and wires is moderating



- Regulated network prices are expected to rise by an average 4.2% per year to 2016/17
- These increases reflect revenue allowances included in existing regulatory determinations made prior to recent network regulation rule changes, which were considered necessary for asset replacement, meeting peak demand and to address new safety obligations
- These determinations end on 31 December 2015. New rules made by the AEMC will be applied in Victoria from 2016 which better equip the regulator to set efficient network revenues, so people don't pay more than necessary

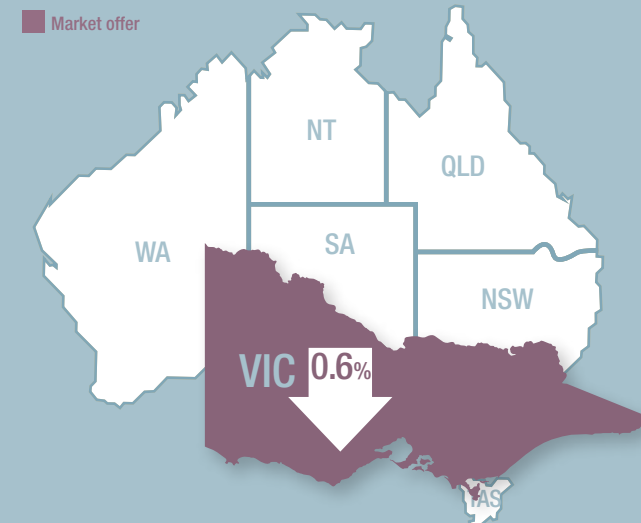
### Environmental policies

The cost of the Renewable Energy Target continues to impact prices

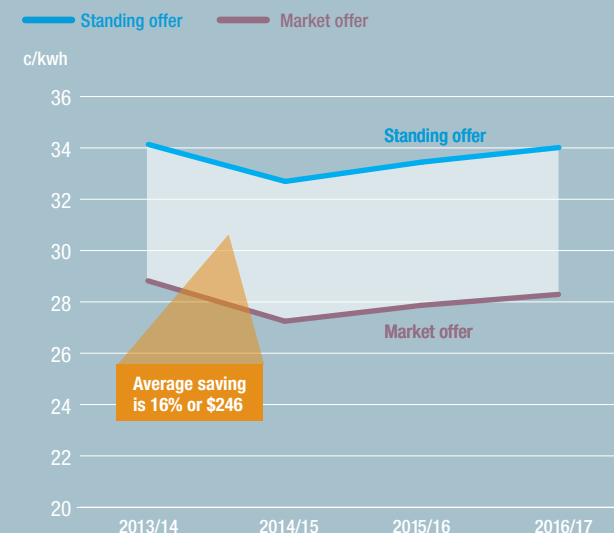


- The fall in prices in Victoria is driven mainly by removal of the carbon price
- Costs associated with the Renewable Energy Target are expected to rise by an average 4.6% per year to 2016/17 and will contribute around 5% of consumer's bills in that year
- The cost of environmental policies, such as feed-in tariff schemes and the Victorian Energy Efficiency Target, are expected to slightly decrease. The recently elected Victorian Government proposed maintaining and expanding the energy efficiency target, and this may impact the price trends set out in this report

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



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



# 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

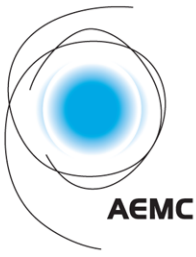
AER develops guidelines in response to the new rules and conducts public consultation under its Better Regulation Program

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 set to moderate in Victoria over the next two years

**The Australian Energy Market Commission (AEMC) today released its 2014 Residential Electricity Price Trends report, which shows prices are expected to increase moderately over the next two years in Victoria.**

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 Victoria were now moderating.

“The cost of supplying electricity has fallen by around 5.5 per cent this year mainly due to the removal of the carbon price, although this is partly offset by rises in other supply chain components. Price increases in the next two years are expected to be below inflation,” Mr Pierce said.

Mr Pierce said the main factors affecting prices in Victoria were falling electricity demand and moderate increases in regulated network costs.

“Wholesale electricity costs are expected to fall slightly, driven by an oversupply of generation capacity due to falling demand.

“Network prices are expected to increase at an annual average 4.2 per cent over the reporting period, reflecting revenue allowances approved for network companies prior to the recent network regulation rule changes.

“New rules made by the AEMC will be applied in Victoria from January 2016, which better equip the regulator to set efficient revenue allowances for network companies so people don’t pay more than necessary for the maintenance and upgrade of the poles and wires.”

He said removal of the carbon price has reduced electricity prices in 2014/15, however other environmental policies like the Renewable Energy Target continue to place upward pressure on prices in Victoria.

“Costs associated with the Renewable Energy Target are set to rise by an annual average 4.6 per cent to 2016/17.”

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

“Victorians could save an average 16 per cent in 2013/14 by switching electricity providers to save on a better deal – or around \$246 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**

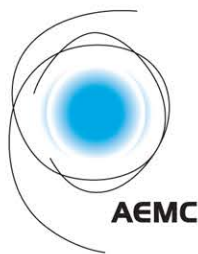
We are the independent body responsible since 2005 for providing advice to Australian governments on development of the electricity and gas sector. We make statutory energy market rules which are applied and enforced by the Australian Energy Regulator (AER).

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EMBARGOED 1pm AEDT, 11 December 2014



## Victoria: Household electricity price trends

Victorian residential electricity prices expected to stay below the rate of inflation over the next two years

**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 Victoria, using an annual consumption level that was provided to us by the Victorian Government.

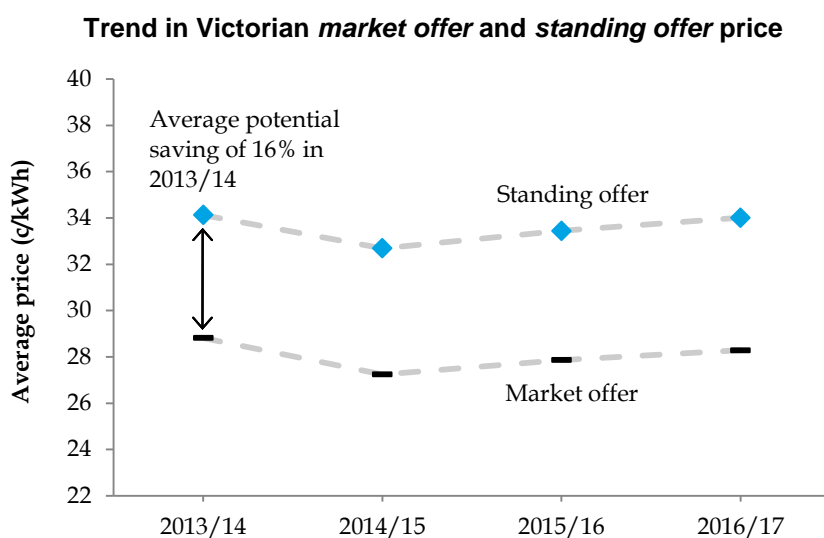
- The annual consumption of the representative consumer in Victoria is assumed be 4,645 kilowatt-hours (kWh).
- Average electricity prices in this report are specific to the representative consumer and may not reflect the pricing outcomes for all residential consumers.

This report does not attempt to forecast prices. Rather, we have analysed cost trends in the competitive parts of the electricity industry including generation and retail, 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 Victoria

On average, *market offer* prices in Victoria have decreased by 5.5 per cent in 2014/15 for the representative consumer, and are expected to increase by 2.3 per cent in 2015/16 and 1.5 per cent in 2016/17. This is equivalent to an annual average decrease of 0.6 per cent over the reporting period, as shown below.

Consumers may have saved around 16 per cent, or \$246, if they switched from the regulated *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.



In July 2014, there were 36 electricity offers available to residential consumers and the difference in the price between the highest and lowest offers, for the representative consumer, was between 9 and 12 c/kWh, depending on the distribution network region.

### Drivers of price trends

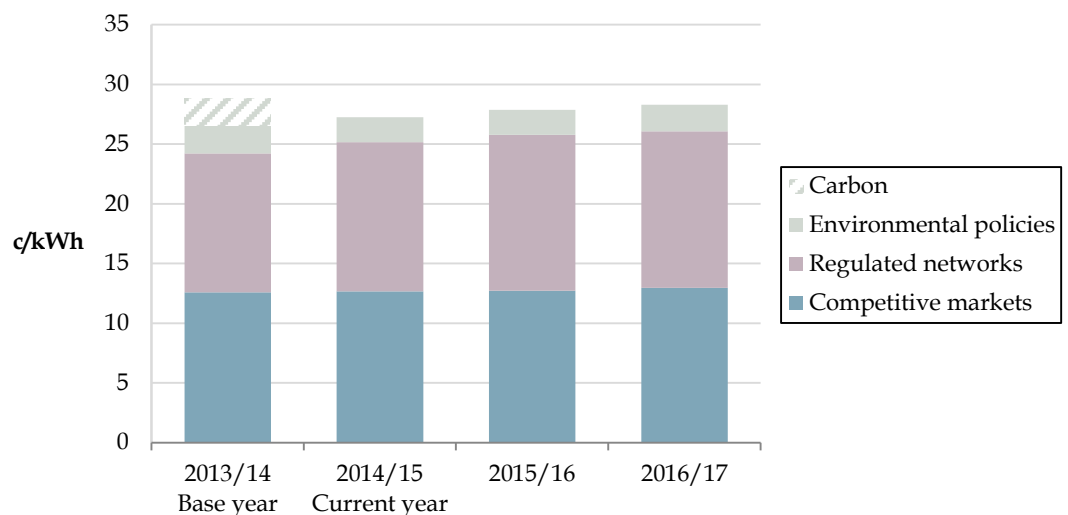
Residential electricity prices in Victoria are forecast to be relatively stable during the period to 30 June 2017, following the repeal of the carbon price.

In 2014/15, residential electricity prices have fallen due to the repeal of the carbon pricing mechanism, although this is partially offset by increases in the other cost components, including a 7.4 per cent increase in regulated network prices.

Expected price movements between 2014/15 and 2016/17 are largely due to increases in the competitive market sector, distribution network prices and costs associated with the Large-scale Renewable Energy Target.

In 2014/15, it is expected that the total electricity bill for a representative consumer in Victoria will consist of around 46 per cent regulated network prices, 46 per cent competitive market costs and 8 per cent environmental policy costs, as shown in the graph below.

**Trend in Victorian 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 around 5 per cent of the total bill for a representative consumer and distribution network prices will make up 41 per cent.
- Regulated network prices are expected to increase at an average annual rate of 4.2 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 rules will apply to the upcoming regulatory periods, meaning that during the three years from 2013/14 to 2016/17, the Victorian network businesses are subject to two different sets of rules.

- The current distribution network determination applies until 31 December 2015, after which time the 2016-20 regulatory period will commence and the new rules will apply.
- The current transmission network determination, made under the previous rules, ends on 31 March 2017 and covers most of the period for this year's report.

### *Transmission network*

Transmission network prices are expected to be stable over the reporting period.

- The current regulatory determination includes a lower regulated rate of return compared to the previous regulatory period, which is primarily due to reduced costs of financing.
- The decrease in the regulated rate of return is partially offset by forecast capital expenditure of \$513 million (nominal) to replace and upgrade network assets.

### *Distribution network*

Distribution network prices have increased on average by 8.4 per cent in 2014/15 and a further increase of 5.1 per cent in 2015/16 is expected.

- The current regulatory determinations include higher levels of capital and operational expenditure compared to the previous regulatory period.
- This expenditure was judged to be necessary for asset replacement, meeting anticipated peak demand growth and to address new safety-related obligations.

Unlike other jurisdictions, the regulatory control period in Victoria is on a calendar year basis for the distribution businesses, not financial year. For the period after 31 December 2015, there is currently no regulatory determination and we assume that there is no increase in distribution network prices.

Actual outcomes will depend on the Australia Energy Regulator's final determination for the five Victorian distribution network businesses. The draft determination is due to be published by 30 October 2015.

### **Competitive market costs**

Competitive market costs consist of 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 increase, on average, by 1 per cent per year. This includes an assumption that the retail component will increase at an inflation rate of 2.5 per cent per year.
- Wholesale energy costs are expected to decline over the reporting period due to low demand growth and growth in renewable energy generation under the currently legislated Renewable Energy Target.

The AEMC's 2014 Retail Competition Review found that there are 16 competing retailers in Victoria – the most of any jurisdiction – and 75 per cent of consumers are on a *market offer* contract. Around 28 per cent of Victorian consumers changed their retailer in 2013, the highest in the National Electricity Market.

### **Environmental policy costs**

The environmental policies that apply in Victoria during our reporting period are the:

- carbon pricing mechanism;
- Renewable Energy Target;
- feed-in tariff schemes; and
- Victorian Energy Efficiency Target.

Costs associated with the carbon price apply only in the base year of the reporting period (2013/14) as the policy has been repealed with effect from 1 July 2014. In 2013/14, these costs made up around 8 per cent of the total bill for the representative consumer in Victoria.

In 2014/15, Renewable Energy Target costs are expected to make up around 4 per cent, feed-in tariff scheme costs around 3 per cent and Victorian Energy Efficiency Target costs 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, on average, by 4.6 per cent per year between 2013/14 and 2016/17.

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

- Feed-in tariff scheme costs are expected to decrease slightly during the reporting period.
- Victorian Energy Efficiency Target costs are phased out during 2015/16 as the former Victorian Government announced that the Victorian Energy Efficiency Target scheme would be closed at the end of 2015.

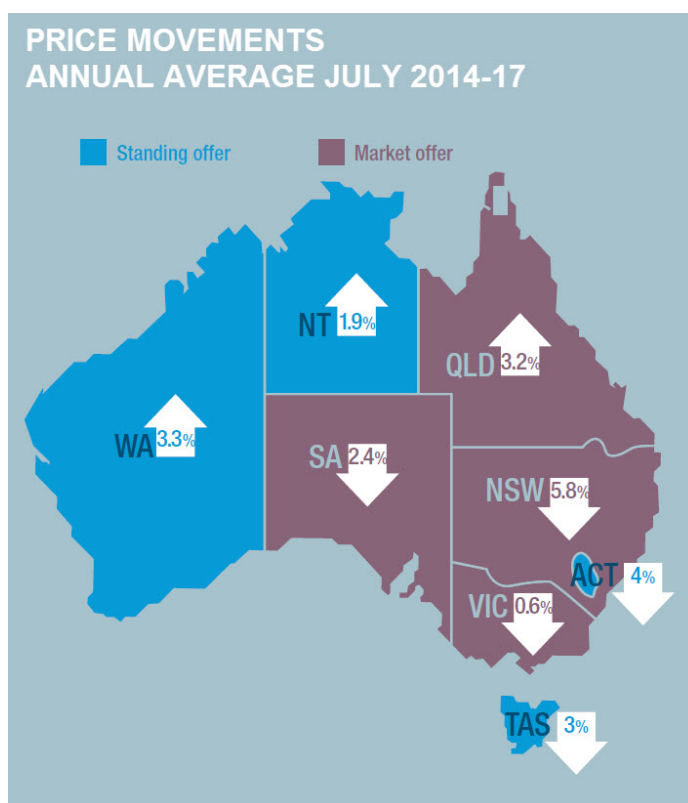
We note that the recently elected Victorian Government proposed maintaining and expanding the scheme, and this may impact the price trends set out in this report.

### Jurisdictional price trends

Trends in residential electricity prices differ between states and territories. In most jurisdictions, prices are expected to fall 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, NSW, 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.

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