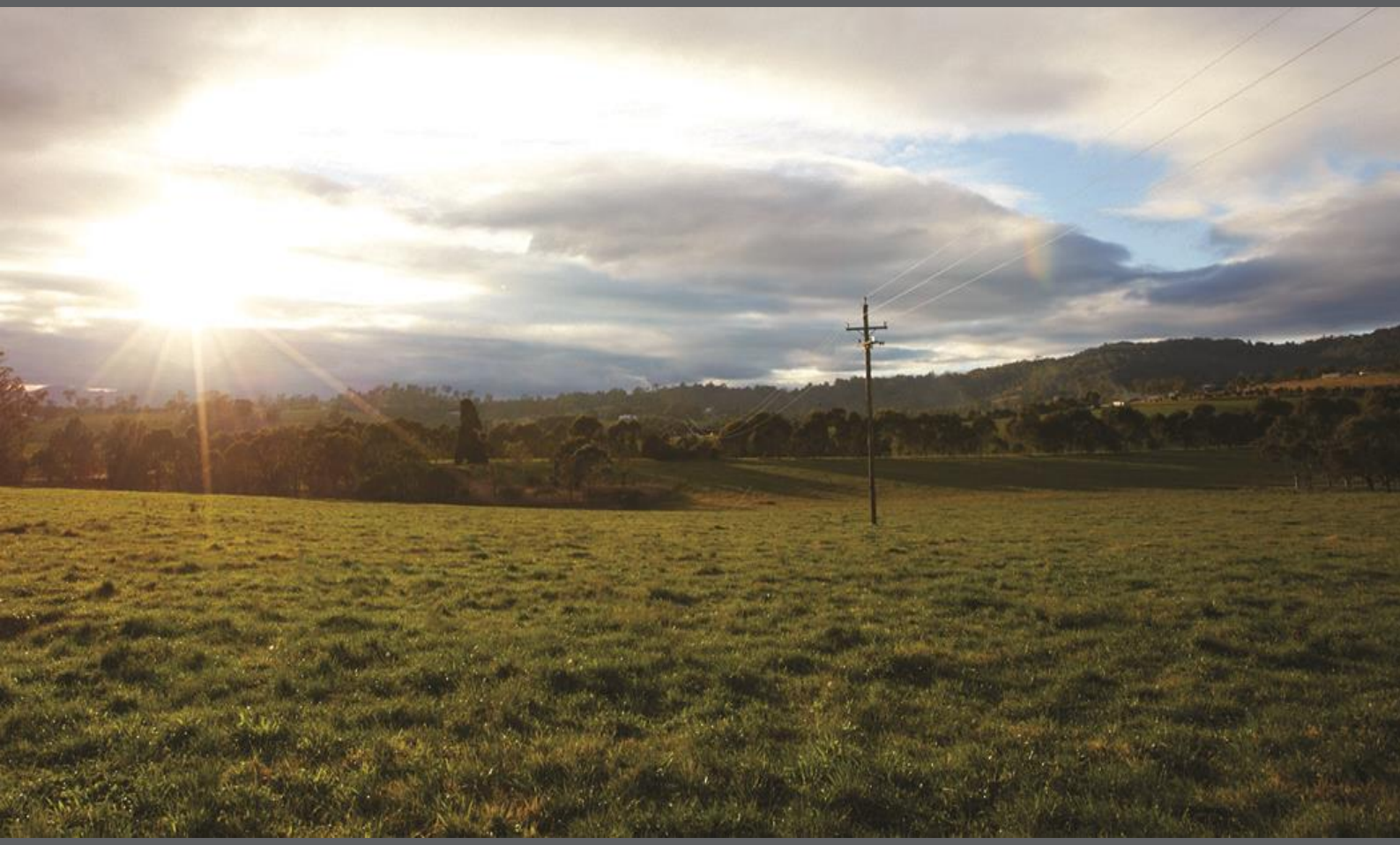
Overview of our Tariff Structure Statement



Your power, your say

4 October 2016

essential energy

A note to our customers

In late 2014, a new National Electricity Rule was introduced, requiring electricity distribution businesses like Essential Energy to introduce network tariffs that provided "efficient pricing signals".

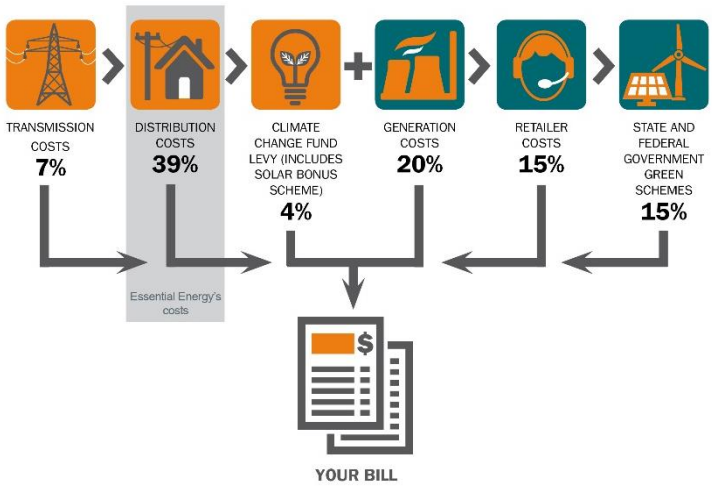
Network tariffs cover the costs of the electricity network, including infrastructure, staff, maintenance of poles and wires and bushfire risk management programs. They make up about 40 per cent of an average residential electricity bill.

In developing our tariffs, Essential Energy aims to reduce real long-term average prices by promoting efficient network investment and utilisation. Our Tariff Structure Statement (TSS) – a requirement of the new rule – sets out how we will achieve this for the two year period from 2017–19.

The key objective of our TSS is to ensure that our customers have a clear understanding of:

- Why we are proposing changes to our tariffs
- Our proposed network tariff structures
- How our tariffs promote efficient network investment and utlisation
- The impact to customers of our proposed changes
- How we plan to transition customers to these new networks tariffs.

John Cleland
Chief Executive Officer



Essential Energy network statistics*

Route line length: (overhead spans)	**181,384 km**
Network area:	**737,000 sq. km**
Customer density: (per km route line length)	**4.78 customers / km**
Zone substations:	**400**
Substations:	**135,000**
Poles:	**1,319,497**
Streetlights:	**154,009**

* Approximate as at 30 June 2015

About our Tariff Structure Statement

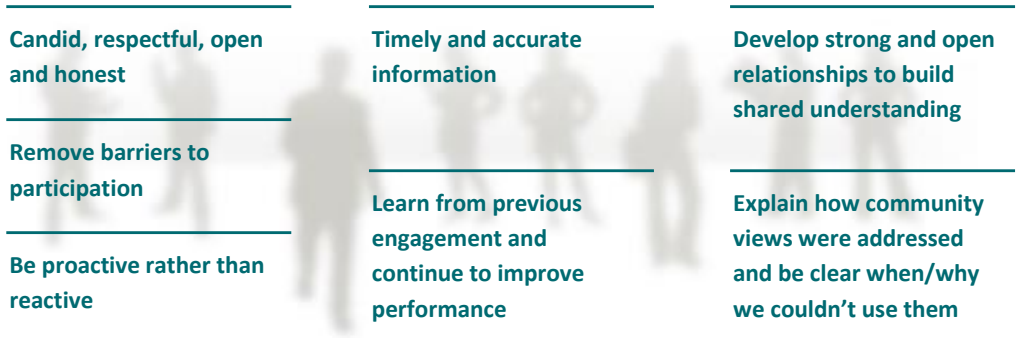
Our initial TSS, for the period 1 July 2017 to 30 June 2019, was lodged with the AER on 27 November 2015. In its draft decision, released on 2 August 2016, the AER did not approve our TSS as it was not considered to be fully compliant with the National Electricity Rules (the Rules).

Our revised TSS addresses the areas of non-compliance raised by the AER and also incorporates feedback from our customers. The AER will assess the revised TSS and make a final decision before any tariff structures and associated pricing begins on 1 July 2017.

The purpose of the TSS is to demonstrate how Essential Energy has adopted the new network pricing objective and complied with the associated pricing principles set out in Section 6.18 of the Rules. Our revised TSS seeks to provide a clear explanation of our network tariffs so as to facilitate a greater level of understanding by customers and enable them to make more informed choices about how they use their electricity service.

As requested by the AER, the revised TSS is a succinct, cut-down version of our initial TSS that specifically addresses only the requirements of section 6.18.1(A) of the NER. The explanations and reasoning for our TSS decisions are attached as a separate addendum to our revised TSS.

Customer & stakeholder engagement



Our approach

Essential Energy's network area spans regional cities, rural farmland and remote rural locations. Understanding the composition of our customer base is critical to meeting the diverse connection, consumption and billing needs of both individual customers and customer groups.

Customer engagement is central to our tariff structure process. We need to consider how customer use of the network is changing and how changes in tariff structures will affect different customer groups. It is also important that customers are able to understand and contribute to the proposed changes.

Our process

Since the AER's draft decision on our TSS we have undertaken numerous face-to-face and one-on-one stakeholder group discussions comprising consumer advocacy groups and Essential Energy's Customer Advocacy Council.

These small group discussions were based on topics raised in the AER's draft decision and provided the opportunity for each stakeholder group to give direct feedback in an intimate setting. This approach worked well as it allowed us to meet with all relevant groups in a condensed period of time and ensured that all stakeholder views were heard and listened to.

Written responses were also encouraged following each meeting, and numerous groups provided these formal written responses. In developing this revised TSS, we have balanced these views with those of the AER and our obligations under the NER.

IPSOS Public Affairs was also engaged to specifically consult with the group of significantly impacted business customers who need to move to appropriate time of use or demand based tariffs. In most cases these customers will experience material increases to their bills and we were keen to work with affected customers to determine an appropriate transition pathway.

How stakeholder feedback has shaped our TSS

Our customer and stakeholder feedback has greatly informed our revised tariff structures. The specific items that have been addressed in our revised tariff structures are:

- The introduction of a flat rate tariff structure instead of a declining block tariff (DBT) structure for our residential and small business customers;
- We have introduced new, more cost-reflective charging windows for all customers with interval (or higher capability) meters;
- We have introduced an opt-in residential and small business customer tariff with a demand component;
- Meter upgrades, solar PV installations and new residential and small business connections will be assigned to a relevant time-of-use (TOU) tariff, depending on their meter type, with the option to select an alternative tariff if they so desire;
- We will implement specific transitional tariffs for approximately 1,000 low voltage business customers currently on DBTs or TOU tariffs that need to move to a demand based tariff and in doing so will experience an increase in their bills.

Future customer and stakeholder engagement

We will continue our customer and stakeholder consultation and engagement in relation to our next TSS as part of our regulatory proposal process for the 2019-24 period. This will take place throughout 2017 and 2018. In the meantime, we encourage customers and stakeholders to provide any comments on this TSS through to us or directly to the AER.

We don't intend to update our tariff structures often, and will only do so after consultation with our customers. The Rules allow us to seek amendments to an existing TSS only for events that occur beyond our reasonable control and that could not have reasonably been foreseen at the time of writing the TSS.

Customer & stakeholder engagement cont'd

Key messages from our stakeholder engagement

"TOU tariffs should be the default tariff"
Most customers would be better off on TOU tariffs.

"Customers should be able to opt-out of TOU tariffs"
This would be a satisfactory compromise.

"We want a demand tariff"
Residential and small business customers should have this option.

"A flat tariff is preferable to a DBT"
DBTs encourage additional consumption, even an inclining block is more preferable.

"Minimise the number of charging windows"
They must be easy to remember.

"Real reform is not possible without smart meters"
This will improve the number of tariff offerings.

"We don't want lumpy bills"
Keep windows simple by avoiding seasonal changes.

"A transitional tariff is a must"
Impacted business customers need time to adjust to the changes.

"Keep us involved"
Transitional tariff customers need special attention to make necessary changes and improvements.

"Customer education is key"
Need to ensure transitional tariff customers understand the impacts of this change.

Our thanks

We would like to thank the following stakeholder groups who helped shape this TSS:

- AGL
- Alternative Technology Association
- Cotton Australia
- Energy Australia
- Energy Consumers Australia
- Energy & Water Ombudsman of NSW
- Essential Energy Customer Advocacy Group
- Ethnic Communities Council of NSW
- NSW Council of Social Services
- NSW Farmers Association
- NSW Irrigators Council
- Origin Energy
- Public Interest Advocacy Centre
- Solar Citizens
- St Vincent De Paul
- Total Environment Centre

Decisions made in this TSS

We will offer a flat rate tariff structure instead of a declining block structure

Most of our stakeholders, including the AER, did not believe that our proposed Declining Block Tariffs (DBTs) for residential and small business customers were as cost reflective as an alternative flat rate tariff. DBTs were seen as encouraging electricity consumption, discouraging investment in energy efficiency measures and result in low users subsidising higher users. Some stakeholders supported a TOU tariff as preferable to a flat rate tariff, but accepted that our current metering population made this option untenable.

Whilst we believe that DBTs do represent a cost reflective option for the majority of customers in our network area, we are not pursuing this argument and are listening to the wishes of our stakeholders instead. As such, we are now putting forward a flat rate tariff structure for our residential and small business tariffs in place of the DBT.

The flat rate structure is easy for our customers to understand, will ensure that both high and low usage customers pay for residual costs in proportion to their use of electricity and is, generally, better aligned with Retailer offerings.

Introduction of a new residential and small business time of use tariff

To speed the progress of tariff reform and provide improved price signals for the bulk of our customers, we will introduce a new TOU tariff for residential and small business customers with an interval (or higher capability) meter that incorporates new, more cost-reflective charging windows. The new charging windows do not include the existing morning peak window.

This offering was supported by our stakeholders who are keen to see charging windows that are reflective of network demand.

We will offer more cost reflective charging windows on most tariffs

The charging windows put forward in the initial TSS were a legacy of our existing metering technology. Most of our meter population are basic accumulation meters, some of which have TOU ability and are currently aligned to our existing TOU charging windows. This is how the charging windows were determined in our initial TSS and we applied these same windows across all tariff types.

We have conducted further analysis and determined the morning peak window is not fully warranted and should be replaced with an extension of the day-time shoulder period. As such, we will alter the charging windows of all relevant tariffs aligned with an interval (or higher capability) meter to reflect this change.

We will not implement this change to our basic accumulation or Type 5 meters. The cost to undertake this piece of work outweighs the benefit of improved price signals to customers, especially as the NSW solar bonus scheme ends this year and full meter contestability begins on 1 December 2017. As such, the expected benefits arising from the costs of reprogramming will be cut short and are likely to occur through market forces in the near term anyway.

Both these decisions were strongly supported by our stakeholders.

In terms of seasonal charging windows, our review indicated that, whilst at a network level there was evidence to support seasonal charging windows, at a locational level there was definitive evidence to support retention of the existing non-seasonal charging windows.

Whilst we have some small engaged customer groups who are at ease with more complex tariff structures, the majority of our customers and stakeholders have made it clear that they favour simplicity in tariff design. On this front, seasonal tariffs were seen as adding increased lumpiness to customer bills and a layer of complexity that should be avoided if possible. On this basis we have decided not to implement seasonal charging windows for this TSS.

Our proposed charging windows for TOU tariffs aligned with basic accumulation meters and Type 5 meters

			AM								PM											
All tariffs		Season	12	→	6	7	8	9	10	11	12	1	2	3	4	5	6	7	8	9	10	11
	Weekday	N/A																				
	Weekend	N/A																				

Our proposed charging windows for tariffs aligned with interval (or higher capability) meters

			AM								PM											
All tariffs		Season	12	→	6	7	8	9	10	11	12	1	2	3	4	5	6	7	8	9	10	11
	Weekday	N/A																				
	Weekend	N/A																				

KEY:

Peak Shoulder Off peak

Decisions made in this TSS cont'd

Revised tariff assignment policy

We have revised the tariff assignment policy put forward in our initial TSS, such that new connections, solar PV installations and meter upgrades for our residential and small business customers will be assigned to the TOU tariff relevant to their metering technology in the first instance, with the choice to opt-out to an alternative tariff.

In conjunction with our new TOU tariff for small and residential customers with an interval (or higher capability) meter, this will ensure that the bulk of our customers will receive more efficient pricing signals than would otherwise be the case. This policy change will encourage the take-up of more cost-reflective tariffs, thereby increasing the speed of tariff reform for the bulk of our customers.

Our stakeholder groups were divided as to whether TOU tariffs should be offered on an opt-in or opt-out basis, but the ability to opt-out was supported as providing a satisfactory solution to a mandatory TOU tariff assignment.

Different rates for shoulder and peak charging windows for large business customers

This was a request from many stakeholders throughout the TSS process. As such, we have started to introduce a greater range between our peak and shoulder rates. We have had to carefully manage customer impacts, particularly in this first TSS, and this is an area we will continue to monitor and adjust in future TSS periods.

Increasing the range in rates between peak and shoulder will make our more efficient tariffs more attractive to customers, whilst also sending improved price signals to customers.

Introduction of a new residential and small business demand tariff

In our initial TSS, we did not offer a residential or small business demand tariff due to the existing high prevalence of low level metering technology for these small customers. This approach was accepted by the AER in its draft decision.

Despite this agreement, we have chosen to make a first step towards a demand based tariff for the majority of our customers and have put forward an optional demand tariff in this revised TSS. This change will satisfy the stakeholder groups who have been requesting such a tariff throughout the TSS process.

Specific transition tariffs for some impacted LV business customers

As part of our TSS we have undertaken specific consultation with those parties who will be more significantly impacted by the forced move to more efficient pricing. These are business customers who have been operating on an existing DBT or TOU tariff, but who do not meet the associated eligibility requirements for the comparable tariff going forward. As such, they require transition to either the appropriate TOU tariff or demand based tariff.

Those customers that require a move to a TOU tariff will experience minimal impact on their final bills. There is also a small number of customers who will experience bill decreases. As such, we are not proposing a specific transition period for these business customers.

However, for most customers, the move to a demand based tariff leads to a significant bill increase. As such we are proposing a specific transitional tariff to phase the increase in over five years. This timeframe is consistent with that offered by other DNSPs and will provide impacted customers with the opportunity to gradually adjust to the higher network charges, whilst also allowing them time to implement any technology and energy saving measures to potentially lower demand and mitigate the impact.

Our tariff setting methodology

The objective of the new Rule is that the network prices we charge each customer should reflect our business's efficient costs of providing network services to that customer.

Specifically, each tariff must be based on the long run marginal cost (LRMC) of providing the service to which it relates to the retail customers assigned to that tariff.

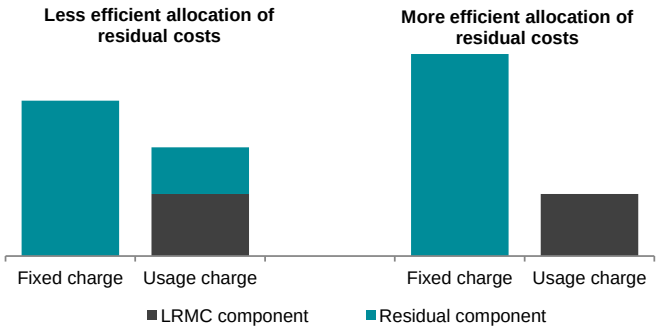
What are 'efficient prices'?

Efficient pricing preserves the LRMC (cost of consuming or supplying one more unit) while also allocating costs that have already been incurred (residual costs) in a way that will provide price stability and take into consideration any impact on customers.

Efficient pricing needs to signal to customers the future network cost of consuming the next unit of electricity. Where there are no network constraints, such as in off-peak times, this cost will be very low. However, if the network is reaching capacity at peak times, the cost to the network of consumers using more energy/demand at that time will grow until it requires us to augment the network to continue to meet the demand. These additional costs should, under the Rules, be reflected in the variable usage charge of the tariff structure.

To encourage customers to make more efficient use of the network (make better use of the spare capacity currently available), more efficient price structures would have:

- A larger fixed component, to better reflect the costs of building and maintaining the current network
- Lower variable charges (reflecting the cost of future increases to the network from additional consumption.)



Balancing efficient prices with the impact of change on customers

Our tariff transition strategy under the new Rules must balance:

- Prices that promote efficient use of the network (within the confines of existing customer meter technology)
- The impact of price changes on customers.

By sending more accurate price signals to customers through our tariffs, we hope to encourage a more even consumption of electricity. This will allow us to defer augmentation (growth) expenditure and, in turn, eliminate unnecessary increases in customer prices.

Adherence to the pricing principles

We have adhered to the pricing principles of the Rules in setting our tariff structures. We have also aimed to:

- Ensure our tariffs are simple and transparent
- Fairly allocate costs between customers based on their share of relevant network costs
- Maintain predictable and relatively stable prices over time
- Empower customers to make efficient electricity consumption choices
- Alleviate or defer unnecessary capital expenditure that would otherwise increase prices to customers.

These goals reflect the requirements of the National Electricity Law and the National Electricity Rules and reflect our understanding of what customers want from their electricity distributor.

The concept of marginal cost and more specifically LRMC is explored in detail in our original TSS.

Our proposed network tariff structures

Our tariff classes

Rather than setting specific prices for every customer on our network, we group customers with similar characteristics together into a tariff class. This ensures that customers with similar consumption profiles and network demand pay similar prices.

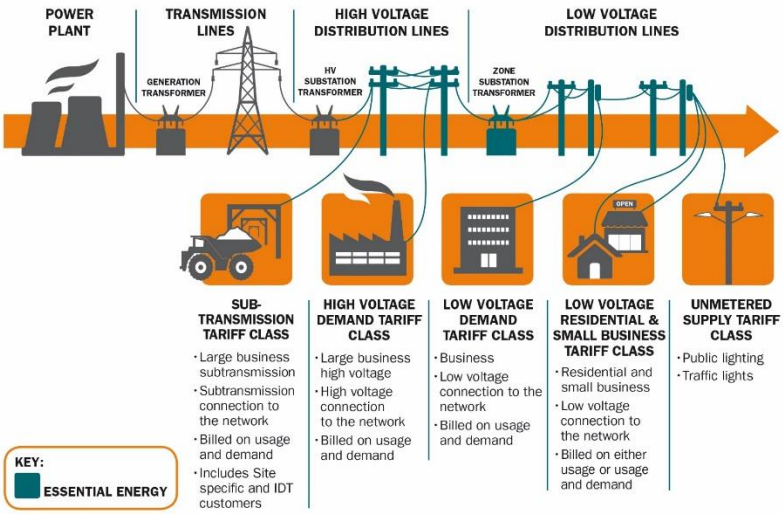
Our tariff classes have been established taking into consideration:

- Historical pricing structures
- Existing metering capability
- The connected voltage level
- The cost-benefit of further disaggregation.

We propose to group our customers into one of the following five tariff classes:

- Subtransmission
- High voltage demand
- Low voltage demand
- Low voltage residential and small business
- Unmetered supply.

These tariff classes are identical to our existing classes except for Inter Distributor Transfer (IDT) customers now forming a part of the Subtransmission class and the relabelling of the existing "Low voltage Energy" tariff class to "Low voltage residential and small business". A summary of our tariff classes, customer types and their associated characteristics is shown in the picture to the right.



Our network tariff structures

Our actual network tariffs will be determined each year through the AER's annual pricing proposal process, but must comply with the structures set out in our TSS. A summary of our proposed network tariff structures for 2017–2019 are set out in the following tables.

Our proposed tariff structures are similar to our current structures with the addition of: revised charging windows (where applicable); a new demand based tariff for residential and small business customers; and a transitional demand tariff for certain eligible LV business customers.

Controlled load customers proposed structures

Tariff	Structure	Charging parameter
Controlled load 1	Fixed	Network access charge as a fixed amount per day
	Energy	Flat rate based on usage with set hours overnight on weekdays and weekends except where the load is controlled by a time clock
Controlled load 2	Fixed	Network access charge as a fixed amount per day
	Energy	Flat rate based on usage with set hours per day on weekdays and all hours on weekends except where the load is controlled by a time clock

Residential and small business customers proposed structures

Tariff	Structure	Charging parameter
Anytime (opt in tariff)	Fixed	Network access charge as a fixed amount per day
	Energy	Two tier declining block tariff
Time of Use (default tariff)	Fixed	Network access charge as a fixed amount per day
	Energy	Peak, shoulder and off-peak rate based on energy consumed in each period
Demand (opt in tariff)	Fixed	Network access charge as a fixed amount per day
	Energy	Peak, shoulder and off-peak rate based on energy consumed in each period
	Demand	Maximum demand charge based on the highest measured half-hour kVA demand registered in either the peak or shoulder periods during the month.

Our proposed network tariff structures

Unmetered customers proposed structures

Tariff	Structure	Charging parameter
LV Unmetered NUOS	Fixed	Network access charge as a fixed amount per day
	Energy	Flat rate based on usage
LV public street lighting TOU NUOS	Energy	Peak, shoulder and off-peak rate based on energy consumed in each period

Large business customers proposed structures

Tariff	Structure	Charging parameter
High voltage – Time of Use average daily demand	Fixed	Network access charge as a fixed amount per day
	Energy	Peak, shoulder and off-peak rate based on energy consumed in each period
	Demand	Demand charge calculated on the average daily time of use demand for peak, shoulder and off-peak periods for the month.
High voltage – Time of Use monthly demand	Fixed	Network access charge as a fixed amount per day
	Energy	Peak, shoulder and off-peak rate based on energy consumed in each period
	Demand	Maximum demand charge based on the highest measured half-hour kVA demand registered in each of the peak, shoulder and off-peak periods during the month.

NB. Eligibility requirements and full details can be found in our TSS document.

Business customers proposed structures

Tariff	Structure	Charging parameter
Low voltage – Time of Use average daily demand	Fixed	Network access charge as a fixed amount per day
	Energy	Peak, shoulder and off-peak rate based on energy consumed in each period
	Demand	Demand charge calculated on the average daily time of use demand for peak, shoulder and off-peak periods for the month.
Low voltage – Time of Use three rate demand Low voltage – Time of Use transitional demand	Fixed	Network access charge as a fixed amount per day
	Energy	Peak, shoulder and off-peak rate based on energy consumed in each period
	Demand	Maximum demand charge based on the highest measured half-hour kVA demand registered in each of the peak, shoulder and off-peak periods during the month.
Low voltage – Time of Use demand alternative	Fixed	Network access charge as a fixed amount per day
	Energy	Peak, shoulder and off-peak rate based on energy consumed in each period
	Demand	Maximum demand charge based on the highest measured half-hour kVA demand registered in either the peak or shoulder periods during the month.

Large business subtransmission customers proposed structures

Tariff	Structure	Charging parameter
Subtransmission – three rate demand	Fixed	Network access charge as a fixed amount per day
	Energy	Peak, shoulder and off-peak rate based on energy consumed in each period
	Demand	Maximum demand charge based on the highest measured half-hour kVA demand registered in each of the peak, shoulder and off-peak periods during the month.
Site specific	Various	Various

Have your say

You can provide feedback on our TSS in a number of ways:

> Send an email to ourplans@essentialenergy.com.au

> Contact us directly via the details at the bottom of this page

What happens next?

> We look forward to hearing more from our stakeholders and will continue to work closely with them on tariff reform

> The AER will make a final decision on our TSS

> The first of our prices developed under our TSS will be introduced on 1 July 2017

Contact us

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