Why did Horizon Power set network tariffs on a nominal basis rather than on a real basis?

Prior to the commencement of each pricing period, Horizon Power is required to publish and consult on its methodology for setting network prices, referred to as the Tariff Setting Methodology.

The Pilbara Networks Access Code 2021 allows the network prices to be set on a:

- nominal basis, which is in the dollars of the day, or
- real basis, which is in the dollars at a specific point in time.

The approach chosen is specified in the Tariff Setting Methodology and applies for the pricing period. Horizon Power's Tariff Setting Methodology stated that its Pilbara network tariffs were set in nominal dollars for the first pricing period (2021-22 – 2023-24), and are set in nominal dollars for the second pricing period (2024-25 – 2026-27).

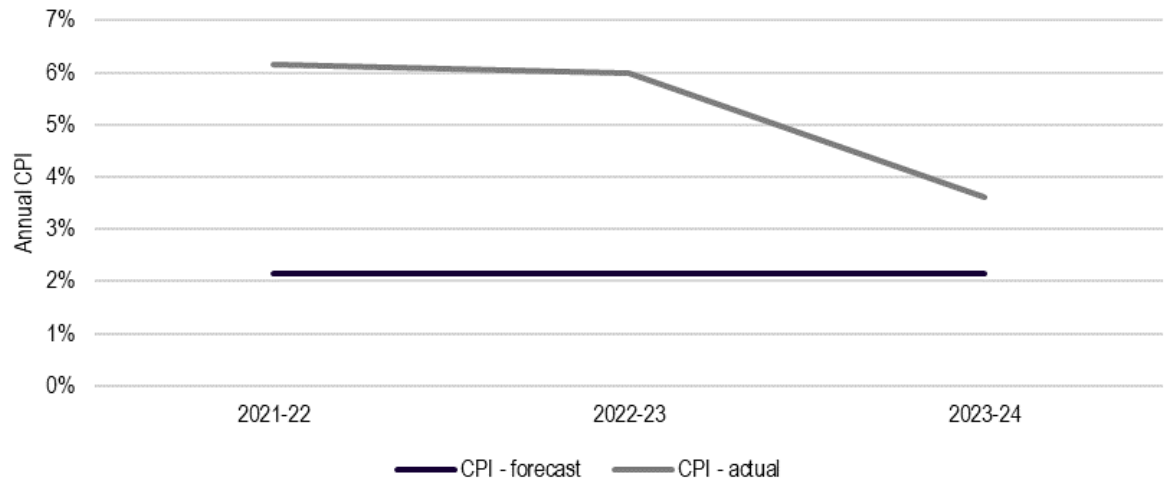
Setting network prices on a nominal basis

If the network prices are set on a nominal basis, they are estimated based on the Consumer Price Index (CPI) that is forecast prior to the commencement of the pricing period but then do not vary over time based on changes in the CPI over time. Horizon Power's customers have the certainty as to the network prices they will be paying over the pricing period, and Horizon Power bears the risk of the difference between the forecast CPI and the actual CPI.

As illustrated in Figure 1, the CPI that was forecast for the first pricing period was lower than the actual CPI. Customers benefited from stable network prices over this period, and Horizon Power incurred the additional costs arising from the higher CPI.

When the network prices were set for the second pricing period, there was a significant uplift in the prices to reflect the higher costs that Horizon Power is forecast to incur during the second pricing period as a result of these higher costs.

Figure 1: The CPI forecast for the first pricing period was lower than the actual CPI



Setting network prices on a real basis

If the network prices are set on a real basis, they are estimated based on the dollars at that time and then increase each year based on the actual CPI. Horizon Power's customers do not know the network prices until shortly before the commencement of each year in the pricing period and they bear the risks associated with cost increases associated with changes in the CPI.

If Horizon Power had set the network prices on a real basis in the first pricing period, customers would have paid higher network prices than they did to reflect the higher costs that were incurred by Horizon Power.

The network prices in the first year of the second pricing period would be similar regardless of whether the network prices were set on a nominal basis or a real basis in the first pricing period. Horizon Power is not able to recover the additional costs it incurred during the first pricing period. However, if the network prices had been set on a real basis in the first pricing period, they would not have increased as much as they did in the first year of the second pricing period with the network prices set on a nominal basis.

The total amount paid by customers over the first pricing period and the first year of the second pricing period is lower with the network prices set on a nominal basis than if they had been set on a real basis.

Protecting customers' interests

Horizon Power sets network prices on a nominal basis as it believes that this protects customers' interests better than if they are set on a real basis as:

1. Customers have more certainty on the network prices to be paid within that pricing period.
2. Horizon Power bears the risk of the differences between the forecast CPI and actual CPI.

However, it may result in a greater fluctuation in network prices from one pricing period to the next.