



MINISTER FOR ENERGY AND UTILITIES
MINISTER FOR SCIENCE AND MEDICAL RESEARCH
MINISTER ASSISTING THE MINISTER FOR HEALTH (CANCER)
MINISTER ASSISTING THE PREMIER ON THE ARTS



MEU Ref: 03/01416

Dr Thomas G Parry
Chairman
Independent Pricing and Regulatory Tribunal
PO Box Q290
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16 SEP 2003

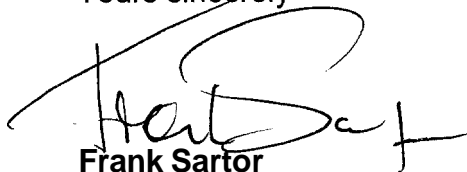
Dear Dr Parry

Review of regulated retail tariffs and charges for electricity to 2007

Pursuant to Section 43EA(1) of the Act, I am referring to the Tribunal, for investigation and report, the determination of regulated retail tariffs and regulated retail charges in each distribution area in New South Wales for the period from 1 July 2004 to 30 June 2007. Please find further details in the attached Terms of Reference to the Tribunal.

Please note that the Government intends shortly to make an amendment regulation, namely the *Electricity Supply (General) Amendment (Tribunal and Electricity Tariff Equalisation Fund) Regulation 2003* to extend the operation of Part 4, Divisions 5 and 6 (concerning regulated retail electricity tariffs and charges, and regulated retail tariffs equalisation respectively) of the *Electricity Supply Act 1995* to 30 June 2007.

Yours sincerely


Frank Sartor

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Terms of reference for an investigation and report by the Independent Pricing and Regulatory Tribunal on regulated retail tariffs and regulated retail charges to apply between 1 July 2004 and 30 June 2007 under Division 5 of Part 4 of the *Electricity Supply Act 1995*.

Reference to the Tribunal under section 43EA

The Minister refers to the Tribunal for investigation and report under section 43EB of the Act:

The determination of regulated retail tariffs and regulated retail charges to apply to small retail customers in each distribution area in New South Wales for the period from 1 July 2004 to 30 June 2007.

Background

In accordance with its commitment to retain the offer of regulated retail tariffs, the Government has extended the current scheme for regulated retail tariffs and charges to apply to small retail customers supplied under a standard form contract. A regulation will be made for these purposes under section 43EJ of the *Electricity Supply Act 1995* to allow the Tribunal to make a further determination of regulated retail tariffs and charges that will apply from 1 July 2004 to 30 June 2007. The Electricity Tariff Equalisation Fund (ETEF) arrangement, which complements regulated retail tariffs, will also be extended for the same period.

Since January 2002, every electricity customer in NSW has had the option to negotiate a retail supply contract with any licensed retailer. Small retail customers who do not seek supply from the competitive market are deemed to receive electricity under a 'standard form' customer supply contract from their 'standard retail supplier'. Customers can also switch backwards and forwards between these alternatives. These arrangements were designed to encourage customers to test the market by providing an assurance that they can return to regulated retail tariffs.

While retail competition has delivered benefits for those participating in the market, the majority of residential and some small business customers have chosen to remain on standard form customer supply contracts which include regulated retail tariffs and charges determined by the Tribunal.

International and national experience shows that the level of regulated retail tariffs relative to market based prices is the key determinant of how many eligible customers remain on regulated arrangements. For example, if regulated retail tariffs do not adequately reflect all of the costs of supply to small retail customers, both those customers and prospective competing retailers have little incentive to enter the competitive market. Therefore, in order to promote retail competition, regulated retail tariffs which are below the cost of supply should be moved towards full cost reflectivity, as far as practicable.

Matters for consideration

For the purposes of section 43EB (2)(a) of the *Electricity Supply Act 1995*, the matters the Tribunal is to consider in making its investigation and report on the setting of tariffs for small retail customers to apply from 1 July 2004 to 30 June 2007 include:

- an allowance for electricity purchase costs based on an assessment of the long-run marginal cost of electricity generation, given the characteristics of the demand of customers remaining on regulated tariffs,
- appropriate retail costs;
- appropriate retail margin;
- an allowance for retailer compliance with any Commonwealth mandatory renewable energy target (MRET) requirements and the licence requirements relating to the NSW Greenhouse Gas Benchmark Scheme;
- energy losses as published by the National Electricity Market Management Company (NEMMCO);
- network charges as determined by the Tribunal and the Australian Competition and Consumer Commission;
- fees (including charges for ancillary services) as imposed by NEMMCO under the National Electricity Code;
- an allowance for expected movements in regulated components and NEMMCO fees.

For the purposes of section 43EB (2)(b) of the *Electricity Supply Act 1995*, the Tribunal must consider the Government's policy aim of reducing customers' reliance on regulated prices and the effect of its determination on competition in the retail electricity market. The level of regulated prices for small retail customers is a crucial factor in encouraging new entry in the retail sector. If the level is set too low, it is not possible for new retailers to attract small retail customers away from the regulated price. This can reduce scale economies for new entrants, increasing their costs and making it more difficult for them to compete. More specifically, the Tribunal is to take account of the following matters in undertaking its review:

- ensuring regulated tariffs cover the costs listed above while recognising consumers' ability to adjust to new prices;
- consider options for restructuring tariffs to promote demand management.

The determination should ensure, as far as practicable, that

- regulated retail tariffs and regulated retail charges are at cost reflective levels for all small retail customers by 30 June 2007;
- the setting of any 'price constraint' should allow the further rationalisation of regulated retail tariffs and movement to full cost recovery over the determination period with regard to the need for a smooth transition for customers; and
- alternative ways be considered to facilitate transition to full cost recovery by 2007, or by an appropriate later date, such as the setting of regulated retail tariffs at cost reflective levels for all new connections and new customers.

The Tribunal should also consider and report on the basis for regulating miscellaneous charges and security deposits.

Consultation

The Tribunal should consult with stakeholders, conduct public hearings or workshops and consider submissions, within the timetable for the investigation and report. The Tribunal must make its report available to the public.

Timing

The Tribunal is to investigate and provide a report of its determination of regulated retail tariffs and charges by 1 May 2004.

Definitions

‘Regulated retail tariff’ means a tariff for or in relation to the supply of electricity required to be charged to a small retail customer under a standard form customer supply contract, being a tariff specified in a determination in force under Division 5 of Part 4 of the *Electricity Supply Act 1995*.

‘Small retail customer’ means a customer that consumes electricity at less than 160 MWh per year as prescribed in clause 7 of the *Electricity Supply (General) Regulation 2001*. A small retail customer is eligible for supply under a standard form customer supply contract.

‘Standard retail supplier’ means a retail supplier to whose retail supplier’s licence is attached a standard retail supplier’s endorsement. A standard retail supplier must impose tariffs and charges for or in relation to supplying electricity under a standard form customer supply contract in accordance with any relevant determination of the Tribunal under Division 5 of the *Electricity Supply Act 1995*.

‘Standard form customer supply contract’ means a contract entered into under Division 3 of Part 4 of the *Electricity Supply Act 1995*.