



Chris Hartcher MP
Minister for Resources and Energy
Special Minister of State and
Minister for the Central Coast

V12/4188

Dr Peter Boxall
Chairman
Independent Pricing and Regulatory Tribunal
PO Box Q290
QVB POST OFFICE NSW 1230

Dear Dr Boxall

Pursuant to section 43EA(1) of the *Electricity Supply Act 1995* (the Act), I am referring to the Tribunal for investigation and report, the determination of regulated electricity retail tariffs and charges in New South Wales for the period from 1 July 2013 to 30 June 2016. Please find further details in the attached Terms of Reference to the Tribunal.

I confirm that an amendment regulation will be made to extend the operation of Part 4, Division 5 of the Act to 30 June 2016, under which the Tribunal's determination may be made.

With regard to gas tariffs and charges, I note that the current standard tariffs for gas small retail customers, previously agreed by the Tribunal and the standard gas retailers under Voluntary Transitional Pricing Arrangements (VTPAs) are due to expire on 30 June 2013.

I further request that the Tribunal continue to regulate the standard tariffs for small retail gas customers for the period 1 July 2013 to 30 June 2016, in accordance with section 27 of the *Gas Supply Act 1996* (the Act). I request that the Tribunal ensure that either new VTPAs or gas pricing orders are in place for the period 1 July 2013 to 30 June 2016.

In regulating such prices, the Tribunal should ensure that the objects under section 3 of the Act are taken into consideration, and that stakeholders are consulted as part of the review process. In order to ensure that standard retail gas tariffs reflect the efficient costs of supplying natural gas to small retail customers, I request the Tribunal to consider whether it should undertake a review of these costs, and to undertake such a review if deemed necessary.

I look forward to the Tribunal's final report on both these matters in time for commencement on 1 July 2013.

If you require further information on this matter, please contact Jessie Foran, Senior Policy Advisor for Energy, in my office on (02) 9228 5289.

Yours sincerely

A handwritten signature in blue ink, appearing to read "Chris Hartcher".

Chris Hartcher MP

Encl. 27.9.12

Terms of Reference for an investigation and report by the Independent Pricing and Regulatory Tribunal (IPART) on regulated retail tariffs and regulated retail charges to apply between 1 July 2013 and 30 June 2016 under Division 5 of Part 4 of the *Electricity Supply Act 1995*.

Reference to IPART under section 43EA

The NSW Minister for Resources and Energy (the Minister) refers to IPART for investigation and report under section 43EB of the *Electricity Supply Act 1995* (the Act) the determination of regulated retail tariffs and regulated retail charges to apply to small retail customers in each standard retail supplier's supply district in New South Wales for the period commencing on 1 July 2013 and terminating on 30 June 2016 or such earlier date as may be directed by the Minister.

Background

The continuation of price regulation is underpinned by two guiding principles:

1. to protect customers from retailers exerting market power where competition is ineffective or yet to be assessed; and
2. to facilitate competition in the electricity market.

A key objective for changing the energy costs methodology is to place downward pressure on regulated retail electricity prices.

The NSW electricity retail market has changed markedly over the past few years. The sale by the former Government of the state owned electricity retail businesses has seen the consolidation of the market share of the three major retailers. These retailers have approximately 83 per cent of the electricity market.

Customers are increasingly moving away from regulated tariffs. Currently, just over half of small retail customers remain on regulated prices in NSW compared with around 66 per cent at the time the 2010-13 determination was completed.

To assist the transition to an effective competitive market, the definition of a *small retail customer* for the purposes of price regulation will be reduced from customers using less than 160 MWh of electricity per year to customers using less than 100 MWh of electricity per year.

The Australian Energy Market Commission (AEMC) has commenced a review of the effectiveness of competition in the NSW energy retail market. This review is scheduled to be completed by September 2013.

In this context, the operation of Division 5, Part 4, of the *Electricity Supply Act 1995*, which deals with *regulated retail tariffs and regulated retail charges* will be extended to allow IPART to make a determination of regulated electricity retail tariffs and charges that will apply from 1 July 2013 to 30 June 2016.

Pending the outcomes of the AEMC's analysis, the Government has set these terms of reference in order to continue to support the objectives of efficient cost recovery, effective competition and maintaining the financial viability of standard retail suppliers.

The NSW Government is concerned about electricity price pressures on customers and is aware of the need to balance these impacts on customers, whilst at the same time facilitating an environment for effective competition to continue to develop.

The NSW Government has implemented a range of measures to assist low income and vulnerable customers meet their energy costs and to place downward pressure on electricity prices. On 1 July 2011, the NSW Government replaced the former Energy Rebate with the Low Income Household Rebate and increased the rebate amount from \$145 per year to \$200 per year. This was further increased to \$215 per year on 1 July 2012. The Government has also increased the Medical Energy Rebate in line with the Low Income Household Rebate.

As from 1 July 2012, the NSW Government commenced the new \$75 Family Energy Rebate for customers who have been assessed as eligible for the Commonwealth Government's Family Tax Benefit A or B. Customers eligible for both the Family Energy Rebate and the Low Income Household Rebate will receive a combined payment of up to \$250 per year. In addition to the increased financial assistance provided to eligible customers, the NSW Government:

- is reforming the state's three distribution businesses to place downward pressure on network charges, which contribute to around half the total cost of electricity bills;
- implemented a new dividends policy that will cap dividends of the NSW Government owned electricity businesses at existing forecast levels;
- commissioned a review of the electricity network reliability licence conditions in response to concerns about the impact of reliability-related capital expenditure on power prices;
- closed the former Government's financially unsustainable Solar Bonus Scheme to new customers to reduce impacts on energy prices; and
- announced the closure of the Greenhouse Gas Reduction Scheme (GGAS) upon the commencement of Federal Government's carbon pricing mechanism.

Matters that must be taken into account

For the purposes of section 43EB(2) of the Act, in undertaking the review set out in this referral, IPART should ensure its determination reflects the efficient costs faced by a Standard Retail Supplier meeting the forecast demand of the regulated customers they are obliged to serve.

IPART's determination for each year this referral is in force should:

- result in prices that recover the efficient costs of supplying small retail customers;
- apply any change in the regulated tariffs on 1 July 2013 and annually thereafter on 1 July or on a date determined by IPART; and
- support the long term interests of consumers of electricity and the stability of the electricity market.

These Terms of Reference refer to three distinct cost components for Standard Retail Suppliers:

1. Energy Costs;
2. Retail Costs; and
3. Retail Margin.

Energy Costs

Energy costs include energy purchases from the National Electricity Market (NEM), greenhouse and renewable energy costs, NEM fees and energy losses.

The Energy Purchase Cost Allowance should be set, using a transparent and predictable methodology.

The Energy Purchase Cost Allowance for each year must be set no lower than the weighted average of the market based approach and the long run marginal cost with the market based approach ascribed a 25% weighting and the long run marginal cost ascribed a 75% weighting.

In addition, IPART must determine the appropriate Energy Purchase Cost Allowance (subject to the floor price) that facilitates competition and promotes efficient investment in, and the efficient operation and use of, electricity services for the long term interests of consumers of electricity.

IPART must develop and consult on the methodology for determining the Energy Purchase Cost Allowance.

IPART must determine two separate regulated load forecasts for the purposes of this determination; one for customers who consume between zero and 40 MWh per year and one for customers who consume between zero and 100 MWh per year. This will be developed, in consultation with the Standard Retail Suppliers to ensure that the efficient costs of a reasonable forecast regulatory load are recovered.

Additionally, IPART should have regard to the efficient costs of meeting any obligations that Standard Retail Suppliers must comply with, including the costs of complying with greenhouse and energy efficiency schemes (including State and Commonwealth schemes in place or introduced during the period this referral is in force). IPART is required to include the final results of the analysis of the total cost impact of these green schemes on the tariffs, expressed as a specified amount based on a typical electricity bill for a residential customer of New South Wales in its Final Report.

IPART should allow for a periodic review of the Energy Purchase Cost Allowance, including the costs of complying with greenhouse and energy efficiency schemes.

IPART should allow for market fees and ancillary fees as imposed by the Australian Energy Market Operator (AEMO) under the National Electricity Rules.

IPART should allow for energy losses as published by AEMO.

Retail Costs

Standard Retail Suppliers incur retail operating costs in supplying electricity customers, which include the costs associated with customer service (e.g. operating call centres, billing and collecting revenue), finance, IT systems, and regulation (e.g. licence fees).

IPART should determine an allowance for retail operating costs based on efficient costs. IPART should take into account NSW Standard Retail Suppliers' efficient costs and other available information on efficient operating costs for retailers.

IPART should ensure regulated retail tariffs are set at a level which encourages competition in the retail electricity market by considering the risks involved in operating a retail energy business and including customer acquisition and retention costs in the retail cost allowance.

Retail Margin

IPART will determine an appropriate margin giving consideration to any material risks not compensated for elsewhere arising from supplying small customers.

Consultation

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

Timing

IPART is to release an Issues Paper (including methodology) and a Draft Report and Draft Determination before releasing its Final Report and Final Determination. It must release its Final Report in time for price changes to come into effect on 1 July 2013.

Definitions

Carbon Pricing Mechanism means that carbon pricing mechanism established under the *Clean Energy Act 2011* (Cth).

Energy Purchase Cost Allowance for a Standard Retail Supplier is an allowance to at least cover the efficient costs of purchasing electricity and managing the risks associated with purchasing electricity, from the National Electricity Market in order to supply electricity for its regulated load, excluding:

- Costs of compliance with greenhouse and energy efficiency schemes (other than the Carbon Pricing Mechanism, which is included in the wholesale energy costs)
- Costs of compliance with any obligations imposed under an applicable law relating to the reporting of greenhouse gas emissions, energy production or energy consumption
- Costs related to physical losses of energy arising during the transporting of energy over the transmission and distribution systems, as published by AEMO
- Any other costs (not referred to in the dot points above) relating to the Standard Retail Supplier's retail supply business or the recovery of any retail margin relating to that business.

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 100 MWh per year. 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 IPART under Division 5 of Part 4 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*.