



New South Wales

Joseph Tripodi

Minister for Energy

Minister for Ports and Waterways

Minister Assisting the Treasurer on Business and Economic Reform

DEUS Ref: S06/160

Dr Michael Keating
Chairman
Independent Pricing and Regulatory Tribunal
PO Box Q290
QVB POST OFFICE NSW 1230

Dear Dr Keating

Pursuant to section 43EA(1) of the *Electricity Supply Act 1995*, I am referring to the Tribunal, for investigation and report, the determination of regulated retail tariffs and charges in each distribution area in New South Wales for the period from 1 July 2007 to 30 June 2010. Please find further details in the attached Terms of Reference to the Tribunal.

I confirm that an amendment regulation will be made shortly to extend to 30 June 2010 the operation of Part 4, Division 5 of the Act, under which the Tribunal's determination may be made.

I note that the current default tariffs for gas small retail customers under voluntary pricing principles and price paths agreed between the Tribunal and individual gas standard retail suppliers expire on 30 June 2007. I further request that the Tribunal continue regulating default tariffs for small retail customers and ensure either new voluntary pricing principles or a gas pricing order under section 27 of the *Gas Supply Act 1996* operate until 30 June 2010, taking into consideration the objects under Section 3 of that Act.

If you require further information in this regard, please contact Ms Dinah Traurig, Manager Competition Strategy, at the Department of Energy, Utilities and Sustainability on 8281 7316.

I look forward to the Tribunal's final report on both these matters by 14 June 2007.

Yours sincerely

A handwritten signature in blue ink that reads 'Joe Tripodi'.

Joe Tripodi
Minister for Energy

30 JUN 2006

TERMS OF REFERENCE

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 2007 and 30 June 2010 under Division 5 of Part 4 of the *Electricity Supply Act 1995*.

1 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 standard retail supplier's supply district in New South Wales for the period from 1 July 2007 to 30 June 2010.

1.1 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 regulatory amendment 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 2007 to 30 June 2010. The Electricity Tariff Equalisation Fund (ETEF) arrangement will be phased out between September 2008 and June 2010 in accordance with the recently revised ETEF Payment Rules.

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. Approximately six hundred thousand NSW customers have now moved on to negotiated tariffs at lower prices.

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. Regulated tariffs set below the cost of supply will also inhibit investment in the new generation required as the demand/supply balance tightens, as investors will not be able to recover their costs. Therefore, in order to promote retail competition and investment, regulated retail tariffs which are below the cost of supply should be moved to full cost reflectivity.

1.2 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 2007 to 30 June 2010 include:

- an allowance for electricity purchase costs based on an assessment of the long-run marginal cost of electricity generation from a portfolio of new entrant generation to supply the load profile of customers remaining on regulated retail tariffs.
- mass market new entrant retail costs
- mass market new entrant retail margin
- an allowance based on long run marginal cost for retailer compliance with any Commonwealth mandatory renewable energy target (MRET) requirements and the licence requirements relating to the NSW Greenhouse Gas Benchmark Scheme, which takes in to account price and volume.
- energy losses as published by the National Electricity Market Management Company (NEMMCO)
- a mechanism to ensure network charges as determined by the Tribunal and the Australian Competition and Consumer Commission (ACCC) and the Australian Energy Regulator (AER) are fully recovered.
- 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.
- a mechanism to address any new, compulsory scheme that imposes material costs on the retailer. For example, the potential for an inter-jurisdictional emission trading scheme
- recognition that ETEF will cease operation within the determination period
- recognition of hedging, risk management and transaction costs faced by retailers in the absence of the ETEF
- recognition of the forecasting risks faced by retailers in the absence of the ETEF
- recognition of Net System Load Profiles (NSLP's) for each standard retailer, as well as projected future changes in those net system load profiles
- the requirement in the NSW Greenhouse Plan to require energy retailers to offer a 10% Green Power component to all new (or moving) residential customers.
- the potential to simplify regulated tariff structures including the potential to remove obsolete tariffs

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
- consider the impact on demand management.

The determination should ensure that:

- regulated retail tariffs and regulated retail charges are at cost reflective levels (including all the costs listed above) for all small retail customers by 30 June 2010
- 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

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

1.3 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.

1.4 Timing

The Tribunal is to investigate and provide a report of its determination of regulated retail tariffs and charges by 14 June 2007.

1.5 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 160MWh 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*.

Mass market new entrant means a new market entrant that is of sufficient size to achieve economies of scale.