

B13/451

9 MAY 2013

Mr John Pierce
Chair
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Pierce

As you would be aware, the Standing Council on Energy and Resources' (SCER) energy market reform package, endorsed by the Council of Australian Governments (COAG) on 7 December 2012, contained a range of measures to progress retail energy pricing reforms. This included the development by the Australian Energy Market Commission (AEMC) of a consistent national methodology for the determination of regulated retail electricity prices.


As such, I request that the AEMC undertake this work in accordance with the attached Terms of Reference.

The Ministerial Council on Energy makes this request pursuant to section 6(b) of the *AEMC Establishment Act 2004* (the Act). In September 2011, COAG created SCER, which includes Ministers responsible for energy. These Ministers comprise the membership of the legally enduring MCE. SCER Ministers responsible for energy are entitled to make requests under the Act.

SCER requests that the AEMC deliver the final report for this tasking by 30 September 2013. This will enable jurisdictions to consider the methodology in the formulation of transition plans outlining a pathway to price deregulation, due to COAG by the end of 2013.

SCER looks forward to continuing to work with the AEMC on this and other important energy market-related matters.

Yours sincerely



Gary Gray

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TERMS OF REFERENCE

AUSTRALIAN ENERGY MARKET COMMISSION (AEMC) REPORTING ON A BEST PRACTICE RETAIL ELECTRICITY PRICING METHODOLOGY

BACKGROUND

In the transition to competitive retail energy markets, most states and territories, except Victoria and South Australia¹, continue to regulate retail electricity prices for small customers on standing offer contracts.

Prices are determined by independent jurisdictional regulators based on wholesale energy costs, transmission and distribution network charges, and retailer operating costs and margins.

While some consistencies exist, there is no uniform pricing methodology employed by regulators across jurisdictions. Regulators broadly employ a building block or cost index approach to determining retail prices. Underpinning these approaches, the determination of individual cost components, particularly wholesale energy costs, has a significant bearing on retail prices paid by consumers. Given the varying methodologies for determining these costs, the AEMC could usefully investigate the development of a more national approach to the setting of retail prices.

In December 2012, the Standing Council on Energy and Resources (SCER) and the Council of Australian Governments (COAG) agreed to task the AEMC to develop a consistent methodology for the determination of regulated retail prices, which jurisdictions may elect to adopt.

SCER and COAG also agreed that this methodology be considered by jurisdictions in the formulation of transition plans, due by the end of 2013, which aim to outline a pathway to price deregulation. These plans will also include consideration by jurisdictions of the potential transfer of responsibility for retail price regulation in accordance with this methodology to the Australian Energy Regulator (AER).

PURPOSE

These Terms of Reference are intended to guide the AEMC's reporting on a best practice methodology for retail electricity price regulation in the long term interests of consumers. Jurisdictions may choose to adopt this methodology where regulation remains necessary or where they consider transferring regulatory responsibility to the AER. While this review is of national electricity markets jurisdictions, the AEMC is

¹ Victoria and South Australia deregulated retail energy prices from January 2009 and February 2013 respectively in response to the existence of effective retail market competition.

*Terms of Reference –
AEMC reporting on a best practice retail electricity pricing methodology*

asked to have regard to applicability to Northern Territory and Western Australia where practicable.

SCER requests this report by the AEMC pursuant to section 6(b) of the *AEMC Establishment Act 2004*.

SCOPE

The AEMC is required to publish a report outlining a best practice methodology(s) for determining regulated retail electricity prices for small customers, with particular regard to how the wholesale energy cost component may be determined and ensuring that retail electricity prices reflect the actual cost of supplying electricity to an individual consumer.

The AEMC should develop the methodology(s) in the interest of delivering regulated retail electricity prices in the long term interests of consumers. The AEMC's methodology(s) should aim to ensure that the approach to retail price regulation reflects the current extent of competition in the relevant market, and is consistent with removing price regulation in the future when competition is effective. The methodology(s) should take account of efficient and cost-reflective pricing to support a viable, competitive and innovative retail market which serves the long term interests of consumers.

In its reporting, the AEMC should give consideration to determining each cost component within regulated retail electricity prices, including:

Wholesale energy costs - This should include consideration of the long run marginal cost of generation and a wholesale market based approach (i.e. based on forward contract and spot prices). The AEMC should also consider other costs associated with market participation including fees and payments.

Network charges - Noting network charges are regulated by the AER and are not subject to this review, the AEMC should only consider this aspect in so far as the pass-through arrangements that apply under retail price regulation or through the application of time-of-use pricing. This includes ensuring that network costs reflect the actual cost of delivering electricity to consumers with regard to how different consumption patterns place different demands on the electricity grid.

Retail costs and margins - The AEMC should consider the margins and efficient costs of retailers.

Government policies and energy scheme costs - The AEMC should broadly consider the most efficient and effective means for regulators of factoring costs (which could be forecast and/or actual) related to relevant government policies and schemes into regulated retail prices.

The AEMC's reporting may also give consideration to other factors and processes associated with the regulatory determination process, such as the timing and duration of determinations and potential pricing review mechanisms.

CONSULTATION

The AEMC must consult with jurisdictions and relevant jurisdictional pricing regulators during the preparation of its report, including providing its draft report for their review and comment.

The AEMC may also consider where appropriate targeted consultation with key stakeholders in the preparation of its report including energy retailers, consumer groups.

TIMING

The AEMC must provide its draft report to jurisdictions for their review and comment by 30 August 2013. The AEMC's final report must be delivered to SCER, and published on the AEMC's website, by 30 September 2013.

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