

Attachment 2

Efficient pricing in the energy market

Terms of Reference to the Essential Services Commission

The Essential Services Commission (the Commission) is requested to conduct a review under section 10(g) of the *Essential Services Commission Act 2001* on the appropriate amendments to the Energy Retail Code to efficiently give effect to recommendations 8A of the Independent Review of the Electricity and Gas Retail Markets in Victoria (the independent review), released on 13 August 2017.

Background

The independent review, commissioned by the Victorian Government in November 2016, found the deregulated energy market was not delivering the anticipated benefits to consumers. It made 29 recommendations designed to place consumers back on a level playing field, including changing retailer marketing practices, introducing a Basic Service Offer (BSO) and abolishing standing offer contracts.

In February 2018, the Government provided its support to the recommendations from the independent review, except for two recommendations - introducing a basic service offer and abolishing standing offer contracts (recommendations 1A and 2A). The Government will undertake further analysis on the application and scope of the BSO and abolishing standing offers and their effect on Victoria's energy sector. The Government will consult further with stakeholders regarding the design of a BSO and any alternatives to the BSO.

Request

The Government is now requesting the Commission to give effect to recommendation 8A.

Recommendation 8A requires the Commission to monitor and report on the competitiveness and efficiency of the Victorian energy retail market. The Commission should have the power to compel the provision of any information required to fulfil its functions, including information on costs and margins.

In conducting its review for the purposes of giving effect to recommendation 8A, the Commission is required to have regard to its objectives under the *Essential Services Commission Act 2001*, *Electricity Industry Act 2000*, *Gas Industry Act 2001* and the following:

- findings from the independent review;
- approaches being used by other regulators, including Australian and International regulators; and
- other matters it deems relevant.

In giving effect to recommendation 8A, the Commission is also asked to develop and apply a methodology for determining an efficient price in the energy retail market – a ‘reference BSO price’. A reference price would have the same characteristics as the regulated BSO described by the Independent Review, namely:

- based on the efficient cost to run a retail business;
- includes an allowance for a maximum retail profit margin; and
- must not include customer acquisition and retention costs or headroom.

The Commission is also requested to develop a framework for assessing the competitiveness and efficiency of the Victorian energy retail market, having regard to the matters identified in recommendation 8A.

The Commission is required to complete and publish its review by no later than 31 December 2019.

Unless otherwise determined by Government, the Commission must develop a pricing methodology that could enable the publication of a ‘reference BSO price’ for electricity and gas offers may be published from 1 July 2018.

Consultation

In undertaking this review, the Commission is required to consult widely, including with consumers, consumer advocacy groups, energy businesses, relevant experts, government departments and other regulators.

Reporting

The Commission will provide regular updates to the Minister for Finance and the Minister for Energy, Environment and Climate Change during this review regarding its progress and its final approach.