

RECEIVED 22 JAN 2013

B13/40

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
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18 JAN 2013

Dear Mr Pierce 

I am writing to you in my capacity as Chair of the Standing Council on Energy and Resources (SCER).

At the 23 November 2012 Standing Council on Energy and Resources (SCER) Energy Ministers meeting, a package of reforms was agreed to, aimed at reinforcing the focus of the electricity market on serving the long-term interests of consumers. These reforms were endorsed by the Council of Australian Governments on 7 December 2012.

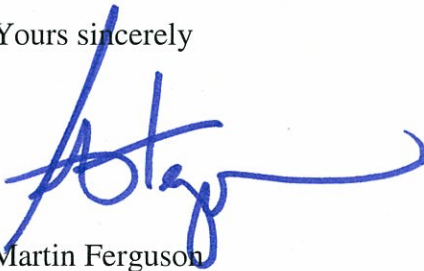
SCER noted recent observations on demand which suggest that, for the first time, there may be a sustained slowing of growth in peak demand and a decline in average demand. This reduced demand has implications for the costs of providing networks for consumers where, currently, network expenditures are approved, in part, on the basis of the investment required to meet forecast peak demand levels.

The recent reduction in demand growth and the ongoing work to empower consumers to manage demand illustrates the need, within the existing incentive regime, for benefits from sustained changes in demand to flow through to consumers. Consequently, SCER agreed to task the Australian Energy Market Commission (AEMC) with investigating the implications of differences between actual and forecast demand within the operation of the network regulatory frameworks and providing advice on the merits of the Australian Energy Regulator considering these differences when undertaking determinations.

I am writing on behalf of Energy Ministers to task the AEMC with developing this advice.

Please find the request for advice attached to this letter.

Yours sincerely


Martin Ferguson

Enc
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Request for Advice

CONSIDERATION OF DIFFERENCES IN ACTUAL COMPARED TO FORECAST DEMAND IN ECONOMIC REGULATORY DETERMINATIONS

Standing Council on Energy and Resources direction to the Australian Energy Market Commission

SCER direction for advice

Pursuant to section 6(b) of the *Australian Energy Market Commission Establishment Act SA (2004)*, the Ministerial Council on Energy (MCE) may direct the Australian Energy Market Commission (AEMC) to provide advice. In September 2011, the Council of Australian Governments (COAG) created the Standing Council on Energy and Resources (SCER), which includes Ministers responsible for Energy. These Ministers comprise membership of the legally enduring MCE. SCER Ministers responsible for Energy are entitled to make requests under section 6(b) and have requested the AEMC to investigate the implications of differences between actual and forecast demand within the operation of the economic regulatory frameworks in the National Electricity Rules (the Rules) and advise on the merits of the Australian Energy Regulator (AER) considering the difference between actual and forecast demand in the previous determination period when undertaking the current determination. This advice should include proposed amendments to the Rules should these be required.

Purpose of this advice

Recent observations on demand suggest that, for the first time, there may be a sustained slowing of growth in peak demand and a decline in average demand. This reduced demand has implications for the costs of providing networks for consumers where, currently, network revenues are set, in part, on the basis of the provision of capacity to meet forecast peak demand levels. The recent reduction in demand growth and the ongoing work to empower consumers to manage demand illustrates the need to consider the merits, within the existing incentive regime, of benefits from sustained changes in demand flowing through to consumers.

This could include analysis of which party bears the risk when forecasts are not realised and the difference of impact depending on whether the control mechanism sets prices or revenue. In identifying options to address these matters, the AEMC should have regard to the need for actions to be proportionate, including the value of maintaining stability and predictability in the regulatory regime, including ensuring sufficient investment certainty.

On 7 December 2012, COAG agreed that SCER task the AEMC with providing advice on the merits of the AER considering the difference between actual and forecast demand in the prior determination period when undertaking the current

determination. While recognising that this may be a complex area, COAG requested that this advice be provided by March 2013, to provide sufficient time for it to be considered and responded to in the mid-2013 SCER meeting.

Request for advice

In the context of the above, the AEMC is directed to provide advice on the merits of the AER considering these differences in demand under the current regulatory framework, and any changes to the current arrangements that could improve the flexibility of the existing framework without compromising the ability of the framework to deliver the National Electricity Objective and meet the pricing and revenue principles. In developing this advice, the AEMC should ensure that any proposed changes are proportionate to the issues identified. If necessary, the AEMC should develop a draft rule change proposal for consideration by Energy Ministers.

In developing this advice, the AEMC is requested to:

- Determine to what extent network revenues are driven by demand levels both in the short term (a regulatory period) and the longer term (asset lifetime).
- Analyse who bears the risk when forecasts are not realised, this should include reference to:
 - the ability of each party to hedge this risk;
 - the broader economic costs of such hedging;
 - the implications of any changes proposed to control mechanisms for networks' incentives to maximise their use of efficient demand management alternatives to network options; and
 - whether the risks are proportionate to the economic consequences of failing to deliver sufficient investment or the underutilisation of assets.
- If the AEMC determines that there would be merit in the AER considering these differences in demand, the AEMC should further determine whether amendments to the Rules are needed to ensure consumers receive the benefits of sustained reductions in demand, including but not limited to improvements to the AER's ability to consider utilisation of previously approved capital expenditure, and improvements to rules around annual network tariff setting. In proposing any such amendments the AEMC should have regard to the need to maintain stability and predictability in the regulatory regime, including ensuring sufficient investment certainty for infrastructure provision and the ability to obtain capital at reasonable rates to facilitate this.

Relevant considerations

The AEMC is to have regard to the following when developing this advice:

- the National Electricity Objective;
- the revenue and pricing principles;
- the incentives for efficient investment contained in the Rules;

- any relevant amendments or issues identified from the AEMC's *Economic Regulation of Network Service Providers Rule Change*;
- the changes in demand identified in the Australian Energy Market Operator's (AEMO) *2012 National Electricity Forecasting Report*;
- the findings from the AEMC's *Power of Choice Review* and SCER and COAG comment on this to date; and
- any other relevant information.

Consultation for the work stream

In conducting the review, the AEMC must consult broadly with stakeholders. This must include, but is not limited to:

- the AER;
- AEMO;
- Energy Ministers and their Officials;
- network businesses; and
- consumer representatives.

Timeframe and deliverables

Energy Ministers require that the AEMC provide its advice by 31 March 2013.

Noting the COAG Energy Market Reform Implementation Plan delivery date for the submission of any rule changes of June 2013, Energy Ministers require written advice about any variation to these timelines.