origin

17 December 2010

Mr Nathan Petrus
Director, Pricing and Analysis
Essential Services Commission of South Australia
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Dear Mr Petrus

Review of Gas Standing Contract Prices 2011/12 - 2013/14: Issues Paper

Origin Energy Retail (Origin) submitted its pricing proposal for gas standing contract customers to the Essential Services Commission of South Australia (ESCOSA) on the 5 November 2010.

Origin notes that ESCOSA has released its *Review of the Gas Standing Contract Prices 2011/12-2013/14 – Issues Paper* (Issues Paper) as part of its inquiry into standing contract gas prices and would like to take this opportunity to comment on several issues raised in the Issues Paper.

In making a pricing determination for standing gas customers, ESCOSA is required to have regard to specific objectives as set out in the *Essential Services Commission Act 2002* (ESC Act) such as to:

> *"promote competitive and fair market conduct, facilitate entry into relevant markets* and *ensure customers benefit from competition…".*[1]

Origin has been a strong supporter of the development of the gas market in South Australia including the facilitation of competition and competitive prices.

Origin is therefore concerned with the suggestion made by ESCOSA in the Issues Paper that retail operating costs and retail margin should be considered on a dual fuel or total energy basis rather than on a standalone fuel basis. In recent years, competition in the South Australian gas market has slowed as a consequence of regulated gas pricing and remains well below that of electricity. Limited retail margins in the gas market have meant the risks outweigh the benefits of targeting gas customers and retailers have solely used dual fuel offers to acquire gas customers.

The duel fuel nature of the market in South Australia suggests that the current level of profitability of a gas customer is not sufficient to neither entice new entrants to the market nor encourage current registered gas retailers to specifically compete in the market. This is supported by the Australian Energy Market Commission (AEMC) and other recent competition reviews that found that retail margins are unattractive in the South Australian gas market and are at or below the bottom of the range required to enter a new market.[2] The AEMC noted margins need to be sufficient to attract competition in the

[1] Section 6, *Essential Services Commissions Act 2002 (South Australia)*.
[2] AEMC, Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in South Australia, First Final Report, September 2008, pxiii.

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South Australian gas market. Origin thus strongly believes that the retail margin and costs need to be determined on a standalone basis to achieve an adequate level of competition. There is also an important competitive neutrality aspect in such an approach that ESCOSA must consider given that in South Australia, sole competing energy retailers hold the obligation to offer gas and electricity standard contracts respectively.

Origin further notes the comments made by ESCOSA that there is no significant population of gas only customers to target as the market trend is either electricity only or dual fuel contracts[3]. Origin believes that this could be said about each and every energy market in Australia. If gas prices, in their own right, do not reflect the costs, retailers will target a combination of fuels or the fuel source that reduces financial and market risks to them. Regulated gas pricing in other States are set on a competitive standalone basis such that retailers can target gas only customers and these customers are the beneficiaries of competition. This is especially true in Victoria where competition is considered sufficient to deregulate prices.

No energy regulator, at a state or national level, considers regulated pricing for energy on a dual fuel or total energy basis. Prices for each fuel source are determined on a standalone basis with the majority of Regulators determining prices based on a new entrant scenario. Origin believes that the South Australian regulated gas market should be treated no differently to other energy markets. Origin believes that if ESCOSA was to pursue this approach of determining retail costs on a dual fuel basis, it would have a negative impact on investment in the gas industry for South Australian small customers. In a national integrated gas market, gas retailers will seek markets where they can find best value, and if risks are high and returns are low, their willingness to supply gas customers in the South Australian market will decline. While Origin will continue to supply small customers, the effects will more quickly be felt on new entrant willingness to offer gas contracts (the standard contract price acting as the upper benchmark, or price to beat, for competing retailers) and thus customer's ability to receive price benefits.

As highlighted in its pricing proposal, Origin's approach to determining a prudent retailer's costs is based on a new entrant retailer and carrying out a benchmarking exercise of recent and relevant regulatory decisions. Retail operating costs and retail margin need to be set to encourage business efficiencies, new entrants, less reliance on regulated prices and thus competition in the gas market.

Origin believes that ESCOSA should be setting prices on a competitive basis with the view that gas retail prices will be de-regulated at the end of the next three year pricing period. To achieve this, prices need to reflect risks and costs and an appropriate price path needs to be set.

If you have any queries in relation to the matters raised in this submission, please do not hesitate to contact me on (07) 3867 0621.

Regards

[redacted]

Caroline Brumby
Regulated Pricing and Policy Manager

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[3] ESCOSA, Review of Gas Standing Contract Prices 2011/12 – 2013/14 – Issues Paper, November 2010, p25.