

Review of Gas Standing Contract Prices: Issues Paper
Essential Services Commission of South Australia
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Via email to: escosa@escosa.sa.gov.au

17th December 2010

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Dear Sir/Madam,

Review of Gas Standing Contract Prices 2011/12 – 2013/14

The South Australian Council of Social Service (SACOSS) welcomes the opportunity to comment on the Review of Gas Standing Contract Prices.

As the peak non-government representative body for health and community services in SA, SACOSS believes in justice, opportunity and shared wealth for all South Australians. We have a strong membership base of individuals and organisations from a broad range of areas in the social services arena. Our major activities cover analysis of social policy and advocacy on behalf of vulnerable and disadvantaged South Australians, independent information and commentary and health and community services sector development. As part of this work, SACOSS has a particular interest in the protection of low income and vulnerable consumers in their interactions with providers of essential services such as gas.

Please find attached a submission outlining SACOSS' position on the Issues Paper released as part of the Review, and the price setting options contained therein.

We note with regret that the level of detailed commentary we are able to provide is sincerely curtailed because documentation about the evidence underpinning justification for movements in changes to pricing are not available to us for review.

That said, SACOSS supports an increase in market transparency to justify any price increases. This is particularly important in relation to increases in fixed supply charges as these have the greatest impact on low income, vulnerable customers who as a result, have no effective capacity to reduce consumption to moderate their costs.

Furthermore, SACOSS questions the market's inability, after seven years of competition, to produce a simple dual fuel contract, despite the fact that all gas retailers also offer electricity and that the majority of gas customers use the same retailer for electricity.

SACOSS is concerned that without a level of market reform, retailers are essentially doubling up administrative services for gas, rather than improving efficiency and reducing the need for additional costs through a streamlined, dual fuel service, increasing the burden of additional costs, particularly for the most disadvantaged.

I hope the comments provided in our submission will be of some assistance in the review process, and if you have any questions regarding the submission, please contact me on 8305 4223 or email ross@sacoss.org.au.

Kind Regards,

A handwritten signature in black ink, appearing to read 'Ross Womersley', written in a cursive style.

Ross Womersley
Executive Director

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The views expressed in this document do not necessarily reflect the views of the Consumer Advocacy Panel or the Australian Energy Market Commission.



SACOSS

*South Australian Council
of Social Service*

**SACOSS Submission to ESCOSA's
2010 Gas Standing Contract Prices**

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Scope of interest

The South Australian Council of Social Service (SACOSS) is the peak body for social services in South Australia, and is an independent non-government organisation with a sixty year history of advocating for disadvantaged and vulnerable South Australians. SACOSS is a not-for-profit independent organisation whose members represent a wide range of interests in social welfare, health and community services. SACOSS is part of a national network assisting low income and disadvantaged people, and shares with its members the vision of *justice, opportunity and shared wealth for all South Australians*.

In its role as a peak body for community services in South Australia, SACOSS covers a broad range of policy areas including the impacts of disadvantage on the most vulnerable South Australians. In recent years SACOSS has led or participated in debate and advocacy in the areas of consumer credit, electricity and gas, telecommunications, financial counselling, payday lenders, food security and gambling.

SACOSS welcomes the opportunity to provide a submission to the Essential Services Commission of South Australia's (ESCOSA) Review of Gas Standing Contract Prices. This submission is part of the Consumer Advocacy Panel-funded National Energy Market Reform Advocacy Capacity Building Project – South Australia.

SACOSS' interest in contract pricing is based on the needs of vulnerable consumers and the implications of any change. It is SACOSS' firm belief that all South Australian gas consumers have an interest in fair and affordable access to essential services.

Introduction

SACOSS welcomes the opportunity to provide comment on ESCOSA's Review of Gas Standing Contract Prices. In this submission we have evaluated the following elements of Origin Energy's proposal:

- Methodology for Fixing Prices
- Form of Price Control
- Cost of Wholesale Gas
- Transmission Costs
- Retail Operating Costs
- Customer Acquisition and Retention Costs
- Residential Energy Efficiency Scheme
- Retail Margin

This submission to the Review of Standing Contract Prices Issues Paper will highlight SACOSS's concerns relating to the proposals outlined by Origin Energy, as well as offering background information and recommendations on the key aspects of the issues paper.

Methodology for Fixing Prices

The Commission is therefore proposing to undertake its Inquiry into gas standing contract prices to apply from 1 July 2011, on the basis of conducting a traditional cost-based approach. Stakeholders are invited to comment on this proposal.

SACOSS has no particular issues with the Commission pursuing a traditional cost-based approach other than to note that due to the commercial-in-confidence nature of many of the costs, it is inherently difficult for a consumer perspective to be provided. The fact that even Origin Energy's proposed customer number and consumption forecasts have been provided to the Commission on a confidential basis indicates the extent to which the decision about commercial interests precludes detailed comment and leaves consumer and consumer advocates at a great disadvantage in forming an argument regarding likely increases in costs (6.2 p21).

Form of Price Control

Comments are invited on the form of price control, including pass through provisions, proposed by Origin Energy.

SACOSS notes that Origin Energy has not proposed the continuation of a rebalancing control in its price submission. SACOSS is concerned that if no rebalancing control is provided, any increase in price will be simply added to the fixed supply charge of the standard tariff.

The table below from ESCOSA's Issues Paper shows the trends in residential gas retail tariffs since the introduction of full retail contestability.

Table 4.2: Residential gas retail tariffs

	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
Origin Energy Retail Residential Tariffs (GST Exclusive, \$ 2010)								
Supply Charge \$/QTR	6.93	13.58	17.21	18.35	19.07	19.41	22.50	21.31
First 4500 MJ (c/MJ)	0.87	0.88	0.89	0.89	0.93	0.94	0.93	0.92
Additional MJ (c/MJ)	0.75	0.76	0.77	0.79	0.82	0.83	0.85	0.88
Origin Energy Retail Residential Tariffs (GST Exclusive, \$ Nominal)								
Supply Charge \$/QTR	5.73	11.44	14.84	16.30	17.35	18.41	21.87	21.31
First 4500 MJ (c/MJ)	0.72	0.74	0.77	0.79	0.84	0.90	0.90	0.92
Additional MJ (c/MJ)	0.62	0.64	0.67	0.70	0.74	0.79	0.83	0.88

Of particular note from ESCOSA's Table 4.2 is the overall increase in supply charge. Whilst the price for the first 4500MJ supplied per quarter has risen by 6% and the price of subsequent consumption increased just over 17%, supply charges have increased by over 300%. Figure 1 below illustrates the rising costs and the dramatic increase of supply charges for residential gas retail tariffs.

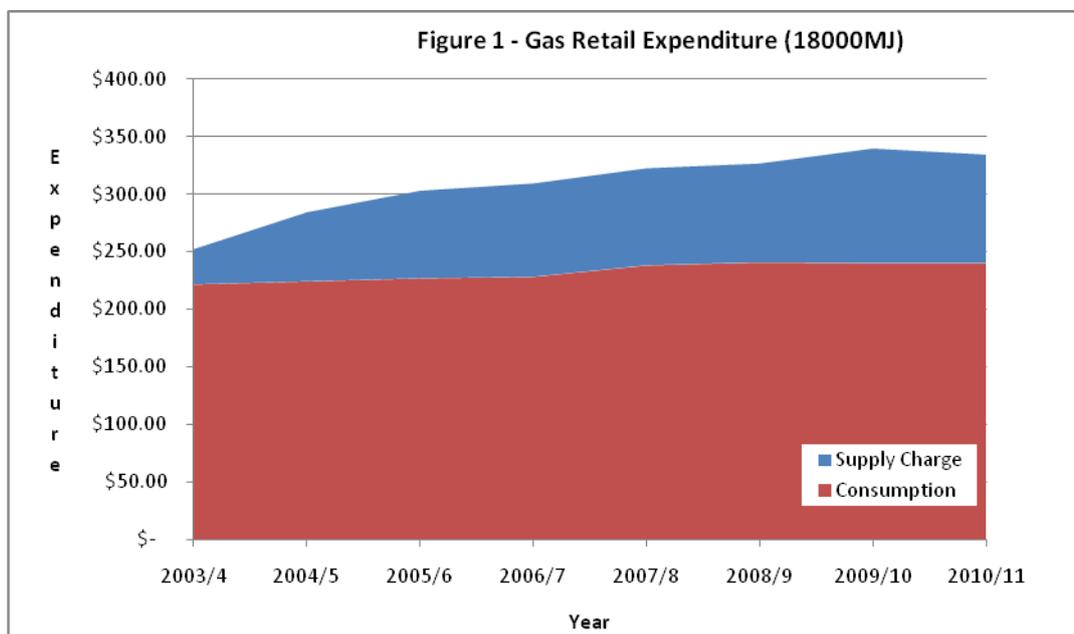


Figure 1 shows that the supply charge for annual residential gas consumption of 18000MJ in 2010/11 comprises over 28% of the total cost compared with just over 12% in 2003/04.

The implication is that smaller consumers will see the largest increase in costs and that persons on the lowest incomes have little means in which to reduce expenditure given that such a large proportion of this bill is directly associated to the connection of gas to the property.

If this represents 'cost reflective pricing' then it can only be assumed that the supply charge will gravitate toward a figure that constitutes ROC plus margin. Without some sort of rebalancing control it is conceivable that it could go even higher.

Cost of Wholesale Gas

Noting that the detailed cost information proposed by Origin Energy remains confidential, the Commission nevertheless invites comment on the cost drivers being put forward by Origin Energy, which it suggests will lead to a significant increase in wholesale gas costs over the next 3-year price path period.

According to Origin (p19) – “Origin expects an increase in wellhead gas cost in 2013-14 due to gas prices moving to export LNG netback price parity from that time”. SACOSS would like to raise two points on this matter. Firstly, it is important to recognise that the world price to which parity is assumed is not guaranteed to stay at current high levels. The combination of significant growth in LNG export capacity, a reluctance by consumers to strike long term contracts and luke-warm economic conditions may lead to downward pressure on the ‘parity price’. It is recommended that ESCOSA take advice on this matter. Secondly, regardless of the potential future world price, there is evidence that LNG exports are unlikely to be a material influence over the price path period.

SACOSS would like to bring to the Commission’s attention the Advocacy Panel commissioned research regarding future gas costs by Engineroom Consulting¹. The research certainly suggests that net-back of export LNG prices is not overly relevant over the price path period. Similarly, ESCOSA’s Final Inquiry Report² for the 2010 Review of Retail Electricity Standing Contract Price Path included a discussion of gas costs over the coming years.

ACIL Tasman were the consultants used by AGL SA to support elements of their proposal. Following a discussion of LNG export’s impact in gas market dynamics, the Commission’s report states (page A-79):

“Due to these offsetting market dynamics, ACIL Tasman concludes that developments in the LNG market on the price of gas for electricity generation for the SA market over the period 2011 to 2014 are likely to be minimal.”

SACOSS would also like to express concern that, according to Origin, the recently introduced Short Term Trading Market (STTM) is cited as justification for an increase in costs. It would be prudent to seek an explanation or rebuttal from AEMO on this matter.

If wholesale gas prices are to gravitate towards world prices then this should be considered as a potential trigger for consideration of an indexing methodology. SACOSS is of the view that the inclusion of an allowance at the start of the regulatory period for a speculative increase at the end of the period is not a prudent approach and is better suited as a pass through item following any future increase in prices.

¹ Gas Pricing – Cost Drivers and Scenarios for Future Price Directions 12 October 2009 available from www.advocacypanel.com.au/documents/ConsumerAdvocacyPanel-GasPricingResearchOctober2009.pdf

² www.escosa.sa.gov.au/library/101208-ElectricityStandingContractPrice-FinalPriceDetermination-PartA.pdf

Transmission Costs

The Commission invites comments on the key drivers of transmission cost changes identified by Origin Energy.

ESCOSA Issues Paper Section 6.4 (p23) “ *Origin Energy has proposed an increase in total transmission costs for MAPS and SEA Gas in 2011/12 due to a higher load factor attributed by Origin Energy to residential and small business customers.¹⁹ In the following two years of the price path, Origin Energy forecasts these main pipeline costs to decrease in real terms.*”

Without access to information regarding the applied load factor it is impossible to ascertain if this is a prudent approach and it is not clear where or not there is an evidence base for the claimed load factor. Additionally, given that Origin Energy forecasts a reduction in main pipeline costs, it is envisaged that any reduction in transmission costs be passed onto the consumer in the form of a reduction beyond 2011/12.

Retail Operating Costs

Stakeholders are invited to comment on the appropriate approach to determining ROC allowances for a standing contract retail gas entity.

Origin have used the Commission's ROC allowance from the draft Electricity Standing Contract Price Inquiry as the basis for their claim. Since every gas customer is also an electricity customer it is hard to accept that 7 years on from the introduction of competition for retail gas that supplying a customer with two fuels costs twice as much as for just one.

See also the comments on CARC below.

Customer Acquisition & Retention Costs (CARC)

Is there a case for setting an allowance based on treating CARC in gas as an incremental cost to CARC in electricity?

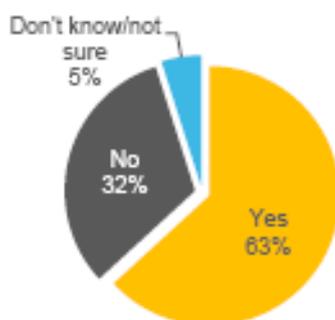
Is it appropriate to address any CARC allowance as part of ROC or Retail Margin?

SACOSS supports the integration of CARC into ROC, rather than as part of the Retail Margin. This said, evidence suggests that most if not all gas customer acquisition is undertaken in conjunction with electricity marketing. For example, in the Monitoring the Development of Energy Retail Competition in South Australia and Consumer Preference for Market Contract Information (ESCOSA, 2010), 63% of households connected to both electricity and gas used the same retailer for both services (see figure below).

5.1.6. Incidence of having the same retailer

The majority (63%) of those who have electricity and reticulated gas in their household have the same retailer for these utilities.

Figure 14: Incidence of having the same retailer



A1 Do you have the same retailer for both electricity and gas?

Base: Those who have both electricity and gas in their household (n=285). Excludes no response

Given that almost two thirds of households have the same retailer for both electricity and gas, replicating a CARC cost for both electricity and gas standing contracts would suggest that the retailer is 'double dipping', charging gas customers for an act that is primarily undertaken as part of the electricity retail process. Replicating the allowance for CARC costs in both electricity and gas standing contracts is inconsistent with protecting the consumer interests.

SACOSS recommends that the CARC cost in gas be an incremental cost of CARC in electricity, given the strong relationship between households using electricity and gas from the same retailers.

Residential Energy Efficiency Scheme (REES)

Is it appropriate to set a firm allowance for REES costs across the three year period, given the material uncertainty over future schemes, activities, and targets or should the uncertainty after the end of 2011 be addressed via a pass-through event for the remainder of the price path?

Given the importance of providing relative certainty for pricing over the three year period, SACOSS recommends that an allowance be estimated to cover REES costs. Largely unforeseen costs such as a National energy efficiency scheme or a modified REES program can be rebalanced via a pass through once the actual costs are known.

SACOSS recommends that an allowance be estimated to cover anticipated REES costs for the duration of the three year period to provide a level of relative certainty in gas pricing.

Retail Margin

Comments are sought on Origin Energy's proposal for an increased retail margin.

Is there a case for considering a retail margin across both electricity and gas (dual fuel) rather than continuing to treat gas as a stand-alone product?

SACOSS supports Origin Energy's integration of CARC into ROC. This said, if CARC is considered to be part of the ROC, rather than as an allowance from the retail margin of 13%, this represents an increase over the current price path. The incorporation of CARC into ROC will presumably increase ROC from existing levels, a cost that will be passed directly onto customers. Similarly, the removal of CARC from the retail margin represents an increase of profits for the retailer, further exacerbated with the proposed raising of the retail margin to 14.6% in 2012/12 and beyond.

If ROC costs are to be increased to accommodate CARC, then the retail margin should be reduced in line with CARC related expenditure to ensure that additional costs are not being passed onto consumers, resulting in excessive profitability for the retailer.

The proposal to increase the retail margin to 14.6% in 2012/12 appears to be largely unjustified. The increase is principally linked by Origin to the prepayment of distribution charges (Origin Public Submission s6.4.2 p26). The details of this requirement are not known to SACOSS but can only be accepted by consumers if it is reflected as a reduction in distribution costs. It would be appropriate for ESCOSA to inquire and report on the treatment of this practice by AER in its current review of Gas Distribution costs.

As has been previously highlighted, there is a strong relationship between electricity and gas distribution, particularly in South Australia where all gas retailers also provide electricity. This suggests that incorporating all retailer related costs into a dual fuel system has the potential to improve efficiency and reduce overall ROC associated with the supply of energy. SACOSS believes that a dual fuel retail margin has the potential to lower overall costs passed on to consumers.

SACOSS recommends that if CARC is integrated into the ROC that the retail margin be reduced from 13%, in line with the increased overall ROC expenditure.

Summary

Overall, SACOSS supports the need for a robust and well regulated market in which essential services are available to all South Australians at an affordable cost. In making decisions on any cost increases, it is important that ESCOSA look through the lens of the most disadvantaged people in our society.

The lack of transparency in the basis for the Origin claims highlights the challenges for consumers in having an equitable voice in this process. It must therefore fall on to ESCOSA to adopt a strong consumer protection position.

It is also clear that after 7 years of competition for gas, the market has failed to produce a simple dual fuel contract and that gas is treated by the retailers simply as a value-add to an electricity market acquisition.

The trend towards increased fixed supply charges in gas tariffs is of serious concern. It is SACOSS's view that this practice must be transparently justified as the most significant relative impact hits those who consume the least and provides no room for vulnerable customers to reduce consumption to moderate costs. The combined fixed charges of electricity and gas supplies are already over double the value of State Government's energy concession.