



10 May 2011

Essential Services Commission of South Australia
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via email: escosa@escosa.sa.gov.au

2011 Gas Standing Contract Price Path Inquiry: Draft Inquiry Report and Draft Price Determination

The Energy Supply Association of Australia (esaa) welcomes the opportunity to comment on the Essential Services Commission of South Australia's (ESCOSA) combined Draft Inquiry Report and Draft Price Determination for the 2011 Gas Standing Contract Price Path Inquiry.

esaa is the peak industry body for the stationary energy sector in Australia and represents the policy positions of the Chief Executives of over 40 electricity and downstream natural gas businesses. These businesses own and operate more than \$120 billion in assets, employ 52,000 people and contribute \$16 billion directly to the nation's Gross Domestic Product.

South Australia has undertaken significant reform to improve the efficiency and competitiveness of the retail gas market. These reforms include the introduction of full retail contestability for all gas customers in July 2004 and the application of a transparent and consultative process to set the standing contract price path for small use customers. Accordingly, since 2005 there have been three retail businesses actively competing with the standing contract gas retailer and as at 31 December 2010, there are a further six retail businesses licensed to sell gas in South Australia. Furthermore, of the total small use gas customers in the state, around 72 per cent are no longer on standing contracts.

The Australian Energy Market Commission (AEMC) undertook a comprehensive review of the effectiveness of energy retail competition in South Australia in 2008 and provided recommendations to the South Australian Government on the continuation of energy retail price regulation. The AEMC review concluded that both the electricity and gas retail markets were effectively competitive, advocating that the South Australian Government remove both electricity and gas retail price controls and introduce a price monitoring regime. Unfortunately however, with the Commission poised to embark on three years of regulatory control, retail price deregulation remains the key outstanding reform inhibiting further development of a competitive retail gas market in South Australia.

esaa supports the development of open, competitive energy markets free from distortions such as retail price regulation. Competition in retail gas markets, as in other sectors of the Australian economy, provides incentives for businesses to improve service, develop products that meet consumer demands and find ways to lower their costs and to pass those costs on to consumers. As a result, markets

naturally encourage prices to be efficient; that is, as low as is sustainably possible while businesses can still make an appropriate return.

Conversely, retail price regulation is an inherently fallible and risk-laden exercise that can be self-fulfilling. Regulating prices in potentially competitive markets whereby regulated tariffs may be set below the cost of supply impedes the efficient operation of the market. It creates financial pressure for industry participants forced to absorb costs that cannot be passed on and removes incentives for energy companies to enter the market and compete for small-use customers. Given the current material uncertainty surrounding future wholesale gas prices in the Eastern States, the risks of continued retail gas market regulation should be acknowledged.

As noted within the combined Draft Inquiry Report and Draft Price Determination, it is expected that increased LNG exporting from Queensland will result in higher domestic wholesale gas prices, with the standing contract retailer anticipating movement towards Export Price Parity (EPP) over the period to 2014. While esaa recognises that there is uncertainty over the exact timing and extent of the LNG impact, the Commission's preference to deal with any transition to EPP through the 2014 gas price review creates a significant and unnecessary level of risk for market participants. Regulated tariffs may be set at non-cost reflective levels and thus compromise the overall competitiveness of the market. While it is noted that there exists the possibility of re-opening the 2011 price determination should wholesale gas prices increase materially over the period, it is not clear as to what constitutes a material increase and how this will be assessed.

esaa also considers that the introduction of efficiency factors and incorporation of retailer operating costs based on those of a dual-fuel retailer – rather than a stand-alone retailer – into regulated tariffs creates unnecessary barriers to entry and potentially suppresses the overall level of competition within the retail gas market.

esaa considers that the South Australian Government should remove gas retail price regulation as per the AEMC's recommendation in 2008. However, should the South Australian Government decide to persist with gas retail price regulation then regulated gas tariffs must be set in a way that ensures that they are at least cost reflective throughout the period under review.

If you require any further information in regard to this submission please contact Kieran Donoghue, kieran.donoghue@esaa.com.au or 03 9670 0188.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Brad Page', with a stylized flourish at the end.

Brad Page
Chief Executive Officer