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2008 Review of Retail Gas Price Path – Draft Decision

Thank you for the opportunity to comment upon ESCOSA's *2008 Review of Retail Gas Price Path – Draft Decision.*

Effective competition is driven by the ability of new entrant retailers to compete with the incumbent retailer at efficient prices. To the extent that regulated prices fail to reflect cost increases, the ability of new entrants to compete at efficient price levels will diminish. The effect will be a decline in competitive activity among those retailers already in the market, whilst non-active licensed retailers will delay any proposed market entry. This is precisely what has occurred in the South Australian gas market, and is likely to be exacerbated by the Draft Decision.

Initially the market was characterised by an influx of new entrants, rapidly eroding the market share of the incumbent retailer, with vigorous competition driving high levels of customer churn (sometimes exceeding churn levels in the electricity market). Recently, however, increased costs of operating in the South Australian gas market have dampened competitive activity. As shown in the table below, transfer rates have fallen well below those in related markets, and despite the issuing of new licenses, the most recent new entrant commenced retailing in 2005, three years ago.

Market	Average Annualised Monthly Transfer Rate Jul07-Mar08
Victoria gas	21.0%
South Australia electricity	20.3%
South Australia gas	13.1%

Price regulation poses an asymmetrical risk to competitive markets. If regulated prices are set too high, the presence of effective competition will ensure that any excess margins available to the incumbent retailer in the short-term will be rapidly eroded. However, if prices are set too low, the ability of new entrant retailers to compete will be restrained, jeopardising future investment signals and threatening the long-term security of supply.

Recognising the asymmetrical risk, there are a number of opportunities for the Commission to review the Draft Decision and adopt a less prescriptive approach to facilitate effective competition:

- The Commission has rejected the proposed real price increase for ACQ in 2010/2011, despite recognising "*uncertainties over future price reviews and the prices that Origin Energy may face following the expiry of certain contracts*." The latter comments suggest that the greater regulatory risk of under-estimating costs should encourage some allowance for additional costs in 2010/11, rather than rejecting the proposal.

- Similarly with respect to swing gas, the Commission agrees that "*the evolving market structure is likely to impose greater risks on retailers in the past [and that there is] significant uncertainty surrounding the estimated cost*". However, rather than providing any allowance for the additional costs, the Commission rejects the proposal by providing no allowance.

- At $89.88, the Commission has established the lowest retail operating cost benchmark of any Australian jurisdiction, as shown in table 8.3. Adopting the outcome of the most recent review (i.e. Queensland) would increase the allowance by over $10, yet still maintain it below the levels in both Victoria and New South Wales.

- Although CPI escalation of operating costs is consistent with Victoria and New South Wales, these states are increasing their benchmark from a much higher base. Queensland, again as the most recent review, applies an index comprising 40% CPI and 60% average weekly earnings. Adopting this method for South Australia would also assist the transition to an allowance closer to other jurisdictions.

We recommend that the Commission review the Draft Decision on the basis of the above comments, with a view to facilitating a more competitive retail gas market.

Please contact me on (03) 8628 1122 if you require additional information.

Yours sincerely,

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