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2008 Gas Standing Contract Price Inquiry
Essential Services Commission of South Australia
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2008 Gas Standing Contract Price Inquiry: Draft Inquiry Report and Draft Price Determination

AGL Energy Limited (***AGL***) welcomes the opportunity to provide comment to the Essential Services Commission of South Australia (***the Commission***) on the 2008 Gas Standing Contract Price Inquiry: Draft Inquiry Report and Draft Price Determination (***the review***).

We are pleased that the Commission is working towards ensuring that the regulated price path which will be effective from 1 July 2008 is determined in a manner so as to ensure the protection of the long term interests of South Australian consumers with respect to the price, quality and reliability of essential services, while at the same time seeking to promote competitive and fair market conduct.

The Australian Energy Market Commission (***AEMC***) has commenced its review of the effectiveness of competition in South Australia for both the gas and electricity markets. AGL is of the view that the AEMC will find the electricity and gas market to be demonstrating effective competition and therefore, the AEMC will recommend the removal of price controls. It is therefore essential to ensure that the price path determined by the Commission in this review is reflective of the true costs to provide gas to consumers, and will allow a smooth transition from regulated retail tariffs to market tariffs following removal of retail price regulation.

Specific to the draft determination, AGL has the following comments:

> **Tariff Rebalancing** – The Commission has opted to retain 'secondary controls' when rebalancing tariffs, and has redetermined the constraint at CPI+3%. As outlined in our submission to the Issues paper, AGL does not support side/secondary controls as they may inadvertently result in cross subsidies. However, should the current arrangements of secondary controls continue, we strongly suggest that sufficient flexibility in tariff rebalacing be provided to Origin Energy. To ensure that tariffs are set at cost reflective levels for all classes of customer, AGL would suggest that the secondary controls that are currently in place (CPI+5% for SME and CPI+7% for residential) continue for the next determination period. The recommended allowance of CPI+3% for SME and residential is too low and may not allow for all cross subsidies to be unwound.
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> **Pass through Costs** – AGL is pleased that the Commission is seeking to ensure that there is sufficient provision in place to allow for the recovery of costs not currently

considered as part of this review, including additional costs relating to the introduction of a carbon trading scheme.

Retail Margin – The Commission has suggested a retail margin of 12% on controllable costs be appropriate, yet in its own analysis and calculations, has derived a value of 12.4%. AGL also notes that the Allen Consulting Group (**AGC**) has derived a retail margin at 13.05% using its 'bottom up approach'. AGL agrees with the Commission that it is appropriate to take into consideration changes in the environment in which Origin Energy operates, such as changes in payment methods for distribution charges, to which both approaches (AGC and the Commission's analysis) take account of. The actual achievement of a benchmark retail margin by a retailer will be entirely dependent upon realistic benchmarks being established for the remaining cost components (eg. operating costs). It should also be noted that if margins are set marginally above realistic levels then any benefit is likely to be competed away as retailers see to attract customers. While AGL supports the margin proposed by Origin Energy of 13%, we believe that at a minimum, a margin of 12.4% should be allowed for in the final determination.

AGL looks forward to assisting the Commission in its review. For enquiries in relation to this submission, please contact Carol Lydford, Manager Regulatory Development on (02) 9921 2511 or carol.lydford@agl.com.au

Yours sincerely,

Elizabeth Molyneux
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