

24 April 2008

Essential Services Commission of South Australia
Level 8, 50 Pirie Street
Adelaide SA 5000

Review of Gas Standing Contract Prices 2008/09 – 2010/11 Draft Determination

Thank you for the opportunity to comment on the Commission's 2008 Gas Standing Contract Price Path Inquiry – Draft Inquiry Report and Draft Price Determination.

Simply Energy has serious concerns about the proposed standing contract price path, and thinks that competition will not be sustainable unless the Final Determination departs significantly from the Draft.

Competition

The Essential Services Commission Act provides that, in performing its function of regulating prices, the Commission must have regard to the need to, among other things, promote competitive and fair market conduct, facilitate entry into relevant markets, ensure consumers benefit from competition and efficiency, and facilitate maintenance of the financial viability of regulated industries and incentive for long term investment. The Gas Act also has the stated object of promoting efficiency and competition in the gas supply industry. There is significant risk that the Draft Determination will not meet any of these objectives.

As Simply Energy noted in its response to the Issues Paper, for the gas retail market to be competitive, standing offer prices must be set at a level that allows second-tier retailers to discount the standing contract prices by a competitive amount, and still make a reasonable return on investment. Discounting the standing offer is the accepted and current convention amongst most gas retailers and the simplest value proposition for consumers to understand.

In determining the standing offer prices, the Commission has made an assessment of the anticipated costs that Origin will incur in supplying gas under its standing contracts. Although this is clearly an important factor, the Commission cannot ensure that prices are set at a level that will promote competition by reviewing Origin's costs alone. In order to meet the objectives described above, the Commission must also take account of the impact that those standing offer prices will have on competition. That is, standing offer prices must be set at a level that will encourage new retailers to enter the market, and existing retailers to participate actively to expand their market share.

It is worth noting that there are only four retailers currently selling gas to residential and small business customers in South Australia. Simply Energy is one of those retailers, but has suspended active marketing of gas. Indeed, the Draft Determination (Figure 2.1) illustrates that both Simply Energy and TRUenergy have not grown their market share since September 2007. The prices proposed in the Draft Determination would lead Simply Energy to seriously consider withdrawing entirely from gas retailing activities in South Australia.

The remainder of this submission deals with some specific aspects of the Draft Determination.

Wholesale gas costs

Simply Energy considers that the draft decision with respect to wholesale gas costs is too low. For a smaller retailer to compete in the South Australian gas market, the price needs to be in excess of that proposed by Origin.

The Commission has reviewed three components of Origin's wholesale gas costs: ACQ, MDQ and swing gas. Simply Energy's cost mix is different to that of Origin, although the total wholesale gas costs proposed by Origin is comparable to the total costs incurred by Simply Energy. This means that the draft decision on wholesale gas costs, which is lower than that proposed by Origin, is also significantly lower than the actual costs incurred by Simply Energy in supplying gas to its customers.

The key discrepancy appears to be swing gas costs. Simply Energy estimates its swing gas costs to be significantly higher than the \$0.05/GJ proposed by Origin and the draft decision amount of \$0.02/GJ. As Origin is the Swing Service Provider of Last Resort (SPOLR), it is not exposed to the maximum SPOLR price of \$1,600/GJ (or can provide swing services to itself at lower cost). By contrast, smaller gas retailers face significant hurdles to hedging against this risk, either because hedging arrangements are costly or because they are simply not available.

Transmission costs

The draft decision transmission cost for residential customers in Adelaide (the region in which Simply Energy operates) of \$1.46/GJ is significantly lower than the costs incurred by Simply Energy for transmission services.

Simply Energy believes that the prices for wholesale gas and transmission will escalate each year similar to [the Origin forecast](#).

Retail margin

In its response to the Issues Paper, Simply Energy asserted that the determination of a standing offer price must take into account costs actually incurred by second-tier retailers in acquiring customers. This is because, for the market to remain competitive, a second-tier retailer must be able to offer a price that is competitive to the standing offer, and which also covers the cost of acquiring that customer. The Commission has failed to take account of the cost to acquire in its Draft Determination.

Instead, on page A-85 of the Draft Determination, the Commission has made allowance for the value of standing contract customers to Origin. The Commission has derived a gas customer value by reference to the one-off acquisition cost of an electricity customer and the relative value of a gas customer. As the value of a gas customer in South Australia is lower than that of an electricity customer, the value that has been attributed to Origin's standing contract customers, and therefore its return on assets, is low.

However, this ignores the actual cost of acquisition for a gas customer on a market contract, which does not reduce simply because the value of that customer is less. In fact, because a gas customer in South Australia typically consumes less (than, say, an electricity customer in South Australia, or a gas customer in Victoria) the acquisition costs represent a bigger proportion of the underlying costs. These are costs that Origin does not incur for its standing contract customer base.

Future regulatory initiatives

Finally, there does not appear to be any allowance in the Draft Determination for the costs of proposed new environmental initiatives, such as the Residential Energy Efficiency Scheme. The costs of this scheme should be allowed for in the standing offer price, and future regulatory initiatives that have a material impact on cost should be recognised as pass-through events.

If you would like to discuss any of these comments in further detail, please contact Nick Koutroumanis, Commercial Manager, on (03) 8807 1135. Simply Energy would be happy to provide to the Commission, on a strictly confidential basis, details of its costs described above.

Yours sincerely

Domenic Capomolla
Chief Executive Officer

Simply Energy (ABN 67 269 241 237) is a partnership comprising IPower Pty Ltd (ACN 111 267 228) and IPower 2 Pty Ltd (ACN 070 374 293)