Australian Power & Gas Pty Limited
ABN 26 118 609 813
Address all mail to:
Locked Bag 5004
Royal Exchange NSW 1225
Telephone: 02 8908 2700
Fax: 02 8908 2701
australianpowerandgas.com.au

17 July 2012

Essential Services Commission
of South Australia
GPO Box 2605
Adelaide SA 5001

Via email: escosa@escosa.sa.gov.au

Dear Sirs

Electricity Standing Contract – Wholesale Electricity Cost Investigation

Australian Power & Gas (**APG**) appreciates the opportunity to respond to the Essential Services Commission of South Australia's (**ESCOSA**) Electricity Standing Contract – Wholesale Electricity Cost Investigation Discussion Paper (the **Discussion Paper**).

APG is a license holder for electricity retailing in South Australia, although not currently operating in the state. APG's assessment of whether to commence retailing in South Australia in large part is dependent on the price determination for the standing contract as it serves as the unofficial price ceiling for market contracts. Changing the methodology for the computation of the wholesale electricity cost (**WEC**), as a core component of the electricity retail supply costs, raises concerns for APG as a prudent retailer seeking to enter the South Australian market as it may not be reflective of APG's ability to manage its wholesale energy costs.

In response to the specific questions raised by ESCOSA, APG provides the following comments:

1. **What approach should the Commission adopt to setting wholesale electricity purchase costs for standing contract pricing purposes and why should this approach be used?**

   APG supports the continued use by ESCOSA of the Long Run Marginal Cost (**LRMC**) to determine the WEC. The use of the LRMC allows for non-vertically integrated, prudent retailers to effectively manage their margins and risks through long term wholesale purchasing arrangements based on LRMC modelling. The certainty provided to retailers through the LRMC versus a market based WEC calculation allows for retailers to compete with a certain degree of predictability and increase the attractiveness of the South Australian market to new market entrants.

   We are also concerned that low liquidity and price volatility in the South Australian wholesale market precludes retailers from being able to reasonably hedge their wholesale costs. South Australia's dependence on wind as a large proportion of its generation capacity allows for higher levels of spot market volatility. Utilising a market based calculation versus the LRMC would expose non-vertically integrated retailers to exacerbated price volatility that will in turn result in increased costs being passed on to consumers.

2. **Is the forward market for wholesale electricity in South Australia sufficiently liquid to provide reliable forecasts of the energy purchase costs of a prudent and efficient retailer with the standing contract obligation?**

   We understand that current information available to ESCOSA indicates that there may be liquidity in the wholesale electricity market. However, APG's understanding is that liquidity has reduced going forward due to concerns about the impact of the price on carbon and potential withdrawal of the carbon price in 2013. Further, the intent to reduce generating capacity through plans by Flinders Power (Alinta Energy) to take approximately 500 MW of base load generation capacity off line for extended periods will impact liquidity in the market and, consequently, result in added risks of price volatility. We do not believe that ESCOSA has factored this reduction in base load power into its consideration of liquidity in the wholesale market.

3. **If so, should the Commission change the WEC component of standing contract prices?**

   For reasons provided in our response to questions 1 and 2, APG does not support ESCOSA changing the WEC component of the standing contract price. The ongoing uncertainty and volatility in the wholesale market due in part to carbon policy, large wind generating capacity and reduction in liquidity will have a material impact on prudent retailers seeking to hedge their wholesale risks. Increasing retailer's wholesale risk in South Australia will have the net effect of keeping new market entrants from retailing in South Australia. The LRMC provides increased stability for non-vertically integrated retailer to effectively manage their wholesale risks.

Overall, APG strongly supports the removal of regulated retail pricing as the best means to increase competition and protect consumer interests in the marketplace. Absent this, APG supports South Australia's current pricing methodology as it provides sufficient headroom and stability necessary to attract new market entrants and foster competition in the retail market.

Should you have any queries or require any additional information, please contact me on (02) 8908 2714 or hpriest@auspg.com.au.

Yours sincerely

Hilary Priest
Manager Government Regulatory Relations
& Compliance