

FACT SHEET

Draft Determination on wholesale electricity costs and the standing contract price

2 October 2012

Background

The Essential Services Commission of South Australia (ESCOSA) sets and regulates retail prices for the 25% of small customers (residential and business customers using less than 160 megawatt hours per annum) who have a “standing contract” offered by AGL SA. The other 75% of customers have elected to sign “market contracts” with their retail provider, which are not price regulated.

In setting the retail price for the standing contract, ESCOSA takes into account all the costs the retailer incurs, including the wholesale electricity cost – the expected cost a prudent and efficient retailer must incur to buy electricity to serve standing contract customers.

To provide retail contracts to electricity to their customers, retailers buy from the electricity spot market. Buying from the spot market means that prices can be very volatile. Prudent retailers generally “insure” against this spot price risk through hedging arrangements. As hedging costs are significant, the wholesale electricity cost is significantly above the average spot price.

The wholesale energy costs represent about a third of the total cost of supplying electricity to retail consumers.

Reasons for the proposed change

In setting the 2011/14 standing contract price in December 2010, ESCOSA did not use its preferred Energy Purchase Cost method (observing market data), as uncertainty over carbon pricing resulted in less public trading of hedging contracts. ESCOSA instead used the long run marginal cost (LRMC) of electricity generation in South Australia. The LRMC is the long-run cost of building new generation plant.

ESCOSA has monitored data on market-based contracts since the 2011/14 price was set and in July 2012 determined there was sufficient evidence to review the wholesale cost component of the standing contract price. Uncertainty over carbon pricing has dissipated and trading in hedging contracts has increased significantly.

Preliminary evidence indicated wholesale costs were lower than had been estimated in 2010 and this was confirmed in a subsequent investigation. Therefore, ESCOSA now proposes to reduce the wholesale electricity cost component of the electricity standing contract price to reflect this change. As a result, ESCOSA proposes an 8.1% reduction in the electricity standing contract price. This would reduce the average bill of a typical residential standing contract customer by around \$160 per annum (GST inclusive).

The Commission has released today a Draft Determination to change the wholesale cost allowance for public consultation.

Providing feedback

ESCOSA welcomes comment from all interested parties on the Draft Determination and will consider all submissions in making its Final Determination. Comments are required by COB 26 October 2012.

The full draft determination can be downloaded from its website (www.escosa.sa.gov.au) and written submissions can be made via email (escosa@escosa.sa.gov.au) or letter (GPO Box 2605 Adelaide SA 5001).

ESCOSA will make a Final Determination in early December and the change in the standing contract price (if any) will apply from 1 January 2013. As the Commission's Final Determination will take account of submissions on its Draft Determination and subsequent changes in wholesale costs, the Commission's Final Determination may be different to its Draft Determination.



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