

5 November 2012

Mr Pat Walsh
Chairperson
Essential Services Commission of South Australia
GPO Box 2605
ADELAIDE SA 5001

Dear Mr Walsh,

Draft Determination – Electricity Standing Contract Price

COTA SA welcomes the opportunity to provide comment on the Commission's Draft Determination of the electricity standing contract price following an investigation of the wholesale electricity cost (WEC) and the identification of special circumstances to warrant such a review.

1. Proposed reduction in the standing contract price

COTA SA is pleased that the Commission has proposed a re-calculation of the regulated WEC price which would result in a reduction in the electricity standing contract price. As the Commission is aware, we have consistently expressed concerns about the impact of higher energy costs for older South Australians. This group represents a major proportion of consumers in the retail energy market who are on standing contract arrangements. A reduction in average household costs in the order of \$160 per annum (reflecting an 8% reduction in the standing contract price) will be most welcome by these householders.

We commend the Commission for taking seriously the circumstances of this significant segment of the electricity market often referred to as "sticky customers" who do not actively exercise market choice or seek more competitive contractual arrangement with the current range of retailers. The Commission has recognised the implications of this consumer blockage on effective competition.

COTA SA considers that the failure of the energy market to adequately respond to the needs of these essential service consumers is a burden that should not be carried by them through increased tariffs in perpetuity. The Commission has acknowledged this is by noting 'standing contract customers pay prices that exceed prudent and efficient costs' (p.69).

2. Headroom allowance in standing contract pricing

For this reason, COTA SA also welcomes the Commission's articulation and analysis of the limitations of the use of a "headroom" allowance in price setting to promote both competition and equity. The inclusion of a "headroom" calculation sets a margin in the standing contract price above the actual wholesale costs to retailers. The technical intention of this approach is

to retain an incentive to customers to move off the standing contract by exercising choice in retail contract.

We concur with the submissions made by SACOSS during this review in questioning the ongoing legitimacy of this practice after ten years of market activity. We do not believe that a case can be sustained for the on-going use of this buffer to promote competition in light of customer resistance to choice. COTA SA supports the conclusion reached by the Commission that:

the “promote competition” benefits of providing headroom in the ESCPD (and in future standing contract price determinations) are far smaller than in the past. (p.71)

However, we also note the Commission’s view that the headroom allowance can protect competition and may be in the long-term interest of all residential customers by generating the benefits of competition, such as product innovation and low prices (p.68). COTA SA accepts that this is a formative rationale for a competitive market. Subsequently, the Commission makes a case for the maintenance of adequate headroom to protect against forecast error and has sought to balance the dual objectives of promotion and protection.

Consequently, the Commission has firmly taken the middle road in formulating price. Drawing on advice from ACILTasman, the Commission has settled upon an electricity purchase cost (EPC) base and added an explicit headroom allowance on the grounds that this approach has the advantage of being ‘more transparent and promotes competition consistently’ (p.71). The headroom allowance has been calculated at \$8.00/MWh (p.75).

COTA SA notes the view expressed by SACOSS that the middle road still means that potentially vulnerable customers on the standing contract will continue to pay more than an efficient market price. We agree that more work in this area is required to reduce the burden on this group of consumers whose needs are met neither by competition nor regulation. We are keen to participate in further discussion on this matter.

We also note on the other side of this proposed re-calculation that AGL (the default provider with 51% of market share, including 21% on standing contracts), has taken a high profile in publicly articulating their view that incentives for investment in the South Australian energy market will be undercut by the Commission’s determination and that they intend to withdraw from investment and promotion activities in the State.

COTA SA considers that this misconstrues the Commission’s efforts to balance the objectives of market promotion and consumer protection within regulative parameters and current market conditions.

3. Statutory obligations

In making this assessment, we appreciate that the Commission has acted with the intention of meeting its statutory objective which is ‘to protect consumers’ long-term interests with respect to the price, quality and reliability of essential services’ (p.24). The Draft Determination sets out sound reasons why the Commission believes that market uncertainty has lessened sufficiently to warrant a “special circumstances” review of the formulation of the WEC – specifically that there is greater certainty about carbon pricing and increased market trading suggests greater liquidity in the market. In short, the wholesale costs to retailers have reduced.

COTA SA does not intend to comment specifically on the technical veracity of WEC assessments based on long-run marginal costs or electricity purchase price approaches, noting that there are apparent advantages to both depending upon the context. However, it is our view that the Commission has sought to ensure that the assessment method used best reflects:

the cost that a prudent and efficient retailer would incur in sourcing electricity for the period under regulatory consideration (p.24)

COTA SA considers that the Commission has met statutory obligations and restored some balance in the calculation of the standing contract price under changed market conditions. We look forward to the Commission's final determination on this matter.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Ian Yates', written over a vertical line.

Ian Yates AM
Chief Executive