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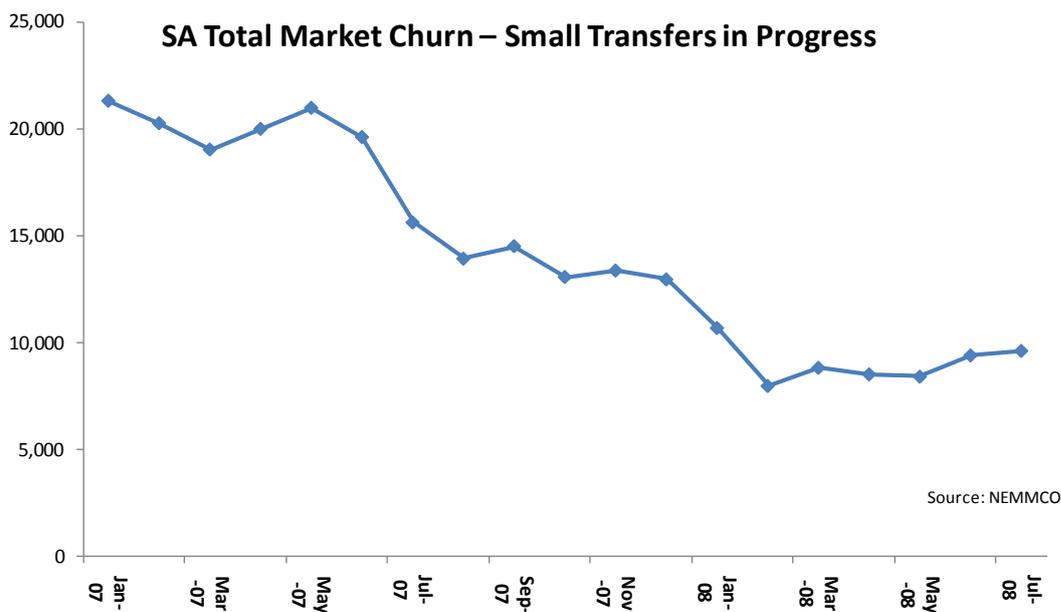
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Review of Effectiveness of Competition in Electricity and Gas in South Australia

Levels of Marketing Activity

AEMC concludes that there is a high level of active competition in South Australia. It is true that there was a high level of marketing in 2006 and 2007 with a number of non-incumbent retailers actively promoting products to customers through discounting. This has the benefit that there are now a number of licensed retailers with customer bases, and systems able to operate in South Australia, including South Australia Electricity.

However, as AEMC is aware, there was a marked drop in sales and marketing activity in South Australia in 2008 and there is far less discounting being promoted in that market. Indeed, switching has fallen by half since the beginning of 2007, as shown in the graph below. The balance of switching is dominated by a natural rate of switching resulting from people moving house, rather than active marketing and sales activity.





This is a direct result of the inadequate margin between costs of wholesale electricity and network charges and prevailing retail prices under the price cap. It is South Australia Electricity's view that South Australia has approached its market with genuine intent to create conditions for competition. However, the fact remains that retail price caps have not been able to keep pace with the underlying costs of energy.

Clearly the cost of energy in the contract market has escalated considerably over the past 12 months, leaving retail prices well behind. There has been a significant change in the market structure at a wholesale level, which has affected not only the cost of energy but the liquidity of energy contract markets. At this stage, it is not clear that this is a short term phenomenon and it may be that the retail market (including regulatory arrangements for retail prices) needs to adjust to those circumstances.

Future Re-entry

South Australia is fortunate in that if retail prices and wholesale prices are brought back into alignment, there are several retailers including South Australia Electricity, ready and able to re-enter the market at relatively short notice. This is one of the important criteria for an assessment of competitiveness. That is, if price caps were to be lifted, incumbent retailers would be constrained in their pricing by the knowledge that other retailers would re-enter, assuming a liquid and competitive wholesale market.

As a result, the most important driver of future competition is the future structure of the wholesale market and the scope for development of independent generation capacity. There are several renewable generation developments being progressed, which may result in SA becoming a net exporter of energy, but on its own this does not signal a re-balance of market power. It is the dispatchable capacity balance at times of market stress that is the correct measure. It is in the interests of consumers and competition in South Australia that further investment in dispatchable capacity proceed, and that ownership of that new capacity be as diversified as practicable.

Gas Market

The South Australian retail gas market is far less competitive than the electricity market precisely because the wholesale arrangements for gas are complicated and illiquid. It is therefore only accessible to larger players with gas fired generation who are able to manage the swing risks and the large scale commodity and transportation commitments. It is not a market that is attractive or even viable for smaller new entrant retailers.

Gas is often quoted as an "add on" to electricity. This may be the case currently, as it was originally in Victoria. However, the Victorian market has since developed into a predominantly dual fuel market. It is SAE's view that South Australian energy retailing will head the same way, escalating the importance of a liquid and competitive gas wholesale market.



Other Barriers to Entry

South Australia is introducing more regulatory burdens for retailers, such as the REES scheme, that requires arrangements for selling and delivering energy efficiency initiatives into homes. While these schemes are an irritation to large established retailers, they can be a serious discouragement for smaller new entrants involving disproportionately large fixed costs.

Similarly, South Australian arrangements for credit support between retailers and network providers has the potential to create a cost of entry that does not exist in other states. In other jurisdictions, a greater variety of credit support arrangements are viable which assists entry and expansion of smaller retailers. It would be very unfortunate if wholesale market structures were improved, with competition then thwarted by onerous and inflexible network credit support arrangements. Eliminating this risk to competition will require the cooperation of both network providers and ESCOSA.
