

8 August 2008

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Email: submissions@aemc.gov.au

SA Retail Review – EOR0017/2

Simply Energy welcomes the opportunity to comment on the Commission's Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in South Australia – First Draft Report.

The First Draft Report appears to address all the issues that materially impact on the competitiveness of the energy retail sector in South Australia. Simply Energy generally supports the conclusions reached by the Commission.

Since the release of the First Draft Report, concerns have been raised publicly by some stakeholders regarding the Commission's preliminary conclusions on profit margins, and Simply Energy wishes to address these concerns in this letter.

The Commission has found that, until recently, competition appears to have constrained retailer market offers to be within or below the plausible range for a competitive market with electricity margins being pushed below the plausible range. The Commission notes that this analysis does not take account of the recent increase in the cost of acquiring wholesale electricity and risk management instruments, which increase has led to existing retailers either temporarily ceasing active marketing or reducing their marketing activities, and to prospective new entrants postponing their plans to enter the market. Simply Energy supports these views.

Some stakeholders have expressed the alternative views that the current low retail margins may be a product of either:

- an abuse of market power by incumbent retailers; or
- transfer pricing between the retail and generating arms of a "gentailer".

Until relatively recently, it has been possible for a retailer to offer a sufficiently attractive discount to the standing contract prices in South Australia to persuade small customers to switch, while at the same time earning an adequate margin. Recent movements in wholesale electricity prices have made this more difficult, meaning that retailers, including Simply Energy, have significantly lessened their marketing activity. The impact of higher prices for wholesale electricity relative to the standing offer prices has been illustrated by a significant drop in churn. The period 2004 to 2007 was characterised by high levels of customer churn. 2007/2008 has seen churn drop to negligible levels (most of the current churn can be explained by customers moving house).

The trend in churn cannot be adequately explained by abuse of market power by incumbent retailers or by transfer pricing.

An abuse of market power would not explain why competition was fierce from the opening of the market until 2007.

Integrated retail and generation businesses typically transact at arm's length. In any event, transfer pricing would not explain why retailers have recently suspended or lessened their marketing activities. That is, even if a gentailer engaged in transfer pricing, so long as the overall operations of a gentailer were sufficiently profitable, it would have no incentive to suspend or lessen its marketing activities.

Simply Energy would be happy to expand on any of these points. Please contact me if you would like to discuss this submission further.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Alex Fleming', with a stylized flourish at the end.

Alex Fleming
Legal & Regulatory Manager