Australian Power&Gas™
Simply smarter energy

Australian Power & Gas Pty Ltd
ABN 26 118 609 813

t 02 8908 2700
f 02 8908 2701
a Locked Bag 1505
Milsons Point NSW 1565
www.australianpowerandgas.com.au

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Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

Re: Review of Small Customer Gas Pricing and Competition in Queensland

Australian Power & Gas (APG) welcomes the opportunity to provide comment on the Queensland Competition Authority (QCA) Review of Small Customer Gas Pricing and Competition in Queensland (Review).

We note that a key consideration of the QCA's review is to assess the existence or level of competition for Queensland small retail gas customers. Key indicators in determining if competition exists or is effective includes indicators such as,

- Independent rivalry within the small customer market,
- Ability of retailers to enter the market,
- The exercise of market choice by customers, etc

APG believes a clear indication exists that competition for QLD small retail gas customers is close to non existent.

As highlighted in the QCA issues paper there are seven retailers that hold a gas license for the QLD market, four of these are classed as inactive, with the remaining three classed as active. However of the three, one (APG) is no longer seeking to take on any new customers (gas or electricity), thereby restricting QLD small retail gas customers to choosing between two incumbent gas suppliers.

A key contributing factor to the lack of competition in the QLD gas market is the current regulated electricity pricing regime and the available capacity of wholesale electricity. **Gas only retailing is not a viable option.**

Electricity retail pricing and available wholesale electricity capacity underpins a dual fuel strategy. In the absence of deregulated / cost reflective electricity pricing and access to wholesale electricity (as is the case for QLD) competition in the QLD gas market will not develop. Further competition levels in the electricity market will fall away.

As a result Queensland customers are left will little opportunity to choose a preferred supplier or have access to differentiated products or services for either their gas or electricity.

If the QLD Government is committed to developing competition in the QLD gas (& electricity) market it must focus on removing barriers to entry by deregulating electricity pricing or by setting regulated prices at a level that accurately reflect participation in the QLD energy market and compel its (own) generators to operate in a non GOC environment.

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For competition to thrive and develop in the QLD market 2nd tier energy retailers are essential, under the current regulatory & political environment there are significant barriers to entry and expansion for 2nd tier energy retailers.

If these barriers are not addresses 2nd tier retailers will not be able to enter or continue to operate jeopardising the development of competition in the QLD energy market.

Following are our detailed comments on the issues raised in the QCA issues paper.

Australian Power & Gas would welcome the opportunity to meet and further discuss with the QCA our views and concerns with the QLD energy market.

Should you wish to discuss any aspect of our submission I may be contacted on (02) 8908 2714 or via email: sruddy@auspg.com.au

Yours Sincerely,

Shaun Ruddy
Manager Regulatory & Compliance
Australian Power & Gas

Australian Power & Gas Submission, Review of Small Customer Gas Pricing and Competition in Queensland

Issues for comment

Competition in the Queensland Gas Market

Australian Power & Gas (APG) strongly believes that the level of competition in the QLD gas market is close to non existent.

Gas only retailing in QLD is not a viable option. Electricity retail pricing and access to wholesale electricity are key factors that underpin a dual fuel strategy. In the absence of cost reflective (deregulated) electricity pricing and access to wholesale electricity supply, the QLD gas market will remain in a stifled state.

If the QLD Government is committed to developing competition in the QLD gas (& electricity) market it must focus on removing barriers to entry by deregulating electricity pricing or by setting regulated prices at a level that accurately reflect participation in the QLD energy market and compel its (own) generators to operate in a non GOC environment.

The Authority invites stakeholders to comment on the following issues,

Are there features of the Queensland gas supply chain that have a bearing on the development of competition in the retail market?

APG hold the strong view that there are features that have a bearing on the development of competition in the retail market. For example the ability to secure capacity on a transmission pipeline and to source gas. As there is no spot market in QLD retailers are required to source both transmission capacity & gas supply which creates an additional barrier to entry in comparison to other jurisdictions such as Victoria.

The requirement to source this capacity and gas supply leads to new entrant retailers facing high upfront fees to be able to obtain capacity. Pipeline operators impose minimum bills (take or pay), which cannot be under written. This in turn means that no new entrant retailer will ever be likely to have the capacity to meet the requirements of their minimum bills. In other jurisdictions there is the potential to reserve capacity for your customer requirements, as opposed to minimum requirements. Available capacity is also an issue for new entrants.

Further given the issues of, minimum bills (take or pay), and upfront costs, a new entrant retailer is not in a position to recover their costs under the current pricing regime, therefore creating both a barrier to entry and expansion.

APG are of the view that new capacity made available on pipelines should be rolled into existing structures so that tariffs remain consistent and an equal playing field is created.

To what extent do retailers compete with each other to acquire new customers and retain existing customers?

APG is not currently competing to acquire new customers, nor are we actively campaigning to retain existing customers (gas or electricity). As shown in the issues paper itself of the seven licensed gas retailers in QLD only three are classified as "Active". APG are classified as active however as stated we are not actively acquiring or retaining customers. Our current activity in QLD is to manage our existing customers. Therefore there are in essence only two "fully" active gas retailers operating in QLD.

Are future profit margins likely to be sufficient to encourage new entry and increase competition or insufficient such that new entry is deterred?

APG believe that existing & future projected profit margins will not be sufficient so as to encourage future investment and new market entry in QLD. **Gas only retailing is not a viable option.** In the absence of cost reflective (deregulated) electricity pricing, which underpins a dual fuel strategy, competition in the QLD gas market will remain stifled.

The recent BRCI decision for the QLD electricity market has further jeopardised the development of competition in the QLD gas market.

Are there barriers facing new, or existing, retailers that affect their decision to enter the Queensland market?

In addition to the comments provided above,

The ability to obtain adequate access to wholesale electricity has a direct impact on the viability of retailers offering gas as part of a dual fuel product offering. As a new entrant retailer APG has been experiencing difficulties in obtaining adequate access to wholesale electricity to serve the QLD market as such this has a flow on effect in our ability to offer a gas (dual fuel) product to customers.

Coupled with the pipeline operators imposing minimum bills, upfront costs and capacity constraints there are significant barriers facing new entrants.

As previously stated, if the QLD Government is committed to developing competition in the QLD gas (& electricity) market it must focus on removing barriers to entry by deregulating electricity pricing or by setting regulated prices at a level that accurately reflect participation in the QLD energy market. In addition it must compel its (own) generators to operate in a non GOC environment.

To what extent might retailers be expected to compete in the small customer market in future?

As a consequence of the issues previously highlighted APG cannot foresee itself increasing its level of activity in the QLD market any time in the near future. Until such time as electricity prices are deregulated or set at cost reflective levels and access to wholesale electricity improved there is no incentive for a 2nd tier retailer to enter or remain in the QLD market.

Are retailers currently competing, or likely to compete, to acquire new customers and retain existing customers?

APG is not currently competing for new gas customers, nor are we likely too in the near future (please refer to previous comments).

Are retailers currently responding, or likely to respond, to customer taste by offering differentiated and better product packages?

APG is not currently competing for new gas customers, nor are we likely too in the near future.

Our ability to actively market gas products to customers is linked to our ability to offer electricity products to customers. As the current electricity pricing determination does not adequately reflect the true cost of supplying electricity to small residential QLD customers (and as gas is an "add-on product") then APG will not be seeking to supply new small residential (gas or electricity) QLD customers for the foreseeable future.

What marketing strategies are retailers currently using to engage with potential customers? What marketing strategies do they propose to use in the future?

APG is not currently involved in any marketing strategies as we do not wish to acquire any new customers in QLD, further from a retention aspect we are not actively seeking to retain existing customers, that is we are prepared to let them leave through natural attrition.

Are customers prepared to switch retailer and, if so what are the reasons behind their choice?

Previous experience indicates that, customers are willing to switch retailers. The major reason for customer switch is price and product offering. However with the level of retailer activity diminishing in QLD customers will be left with fewer options in choosing their preferred gas (or electricity) retailer.

Are customers able to make an informed choice to switch gas retailer or are there obstacles to customers effectively participating in the competitive market?

Adequate information is generally available for customers to allow them to make an informed choice, however a major obstacle for customers is the lack of active gas retailers operating in the QLD market which restricts actual offers available to customers. Please refer to our previous comments on the number of active QLD gas retailers.

Is there sufficient information available to customers about there options and is this information easily accessible and able to be understood by them?

Please refer to comments above. Where information is provided to customers (by retailers) it is in a retailers best interest to ensure the information provided is accurate and easy to understand. Generally all retailers prescribe to this philosophy.

Gas Prices for Small Customers

APG are of the firm view that price regulation (gas & electricity) should be removed or regulated prices set at a level that accurately reflects the cost of operating in the QLD energy market.

Where prices are deregulated the market will set what is an effective price and in turn drive competition. The deregulation or the setting of cost reflective regulated energy prices will aid in the removal of barriers to market entry and promote competition.

The Authority invites stakeholders to comment on the following issues,

How should the retail cost of supplying natural gas in Queensland be assessed?

As previously noted APG hold the firm view that price regulation should be removed and market forces left to set appropriate retail prices.

However if the QLD government is set to continue with price regulation the assessment of the retail cost of supplying gas in QLD must take into account the market dynamics, including;

- Market costs,
- Distribution and Transmission costs,
- Wholesale gas prices / risk,
- Availability (scarcity) of supply,
- Retailer operating costs,
- Need for future investment, and
- Reasonable profit margin (so as to promote competition and future investment),

We note the Authority anticipates using a benchmark approach in assessing the cost of supply; any benchmark approach will need to take into full consideration the nuances that exist with the QLD gas market, not to mention the difference in the economies of scale that exist between incumbent and new entrant retailers.

The pricing methodology must also recognise that through any determination period key elements that go to the make up of retail pricing are subject to change, where change occurs a mechanism must be maintained where by the determination can be reopened to reassess the cost elements that go to determining the retail cost of supplying gas in QLD.

How should the wholesale cost of supplying natural gas be assessed?

In assessing the wholesale cost of supplying natural gas to small QLD customers consideration needs to be given to future investment and the cost of competing fuels. The Liquefied Natural Gas facilities that are being built in Gladstone and QLD will impact the price of Natural Gas. Also the fact that pipeline operators will be seeking acceptable margins in order for them to continue to invest must not be overlooked.

Again sacristy and availability or access to gas needs to be given due consideration, taking into account economies of scale between incumbents and new entrant retailers and their ability to source supply.

Retail Operating Costs

The Authority invites stakeholders to comment on the following issues,

What are the operating costs incurred by retailers in Queensland?

Retailers are faced with a number of operating costs these include;

- Customer acquisition and marketing costs,
- Market system and administration costs,
- Customer administration & management costs, (concessions, billing, etc),
- Distribution and transmission costs,
- Compliance costs, and
- Credit and bank guaranties (Distribution , market administration)

Do retail operating costs vary for customers with differing consumption levels within the small customer class and /or locations?

Generally speaking retail operating costs do not vary greatly across differing consumption levels, however different classifications of customers can have an impact on the operating costs in terms of customer management and administration. For example the administration and customer management costs associated with customers, who are receiving a concession or government benefit that is administered buy a retailer, are generally higher then those that are not.

What are the fixed and variable components of retail operating costs?

Within a retail operating cost, for example Customer acquisition & marketing costs there may be both fixed and variable costs components.

The level of fixed and variable component costs can vary depending on the method of acquisition and contributing factors such as whether the activity is in-house or outsourced. The same goes for customer administration and management; there is generally a fixed component around system operations with a variable component based on customer numbers. Again this would vary between retailers based on whether their activities are carried out in-house or outsourced

What are the likely operating costs of retailers in other jurisdictions? What retail cost benchmark should apply?

Generally speaking the type or form of retailer operating cost does not vary greatly across jurisdictions. However the cost itself may vary considerably and is influenced by factors such as incumbency, market regime, regulatory & compliance framework, etc.

The retail cost benchmark that should apply to the QLD gas market needs to take into consideration the nuances that exist in the QLD gas market as these create additional operating costs that may only be applicable for the QLD market. An example is the additional administration cost in managing and administering the *"Reticulated Natural Gas Rebate".* This is a unique concession that does not exist in any other jurisdiction. Hence retailers incur this operation cost in the QLD gas market that they do not incur in any other gas market.

Retail Margin

As previously discussed APG are of the firm view that price regulation (gas & electricity) should be removed or cost reflective regulated prices installed. In deregulating prices the market will set what is an effective price and in turn drive competition. This will result in setting an appropriate retail margin. The deregulation of energy prices or the installation of cost reflective regulated pricing will aid in the removal of barriers to market entry and expansion.

The Authority invites stakeholders to comment on the following issues,

What is the most appropriate basis for assessing the retail margin for Queensland retailers?

As previously noted APG hold the firm view that price regulation should be removed and market forces left to set appropriate retail prices, this will in turn set an appropriate retail margin.

However if the QLD government wish to continue with price regulation then when assessing the retail margin, all of a retailers cost of market participation must be included. For example,

- Return on capital,
- Deprecation,
- Taxes,
- Operating costs,
- Market costs &,
- Investment.

Retailers need to be assured that the regulated retail gas pricing is sufficient to cover their actual costs of operating in the market with the inclusion of a reasonable profit or return. The absence of a reasonable return will limit the ongoing viability of the retailer and will jeopardise future investment thus have a detrimental impact on competition.

As previously highlighted a gas only product is not a viable option for retailers therefore the electricity retail margin also needs to be sufficient in order to have a flow on effect in providing retailers the ability to offer dual fuel contracts thereby increasing competition in the gas market. The electricity retail margin in QLD is **not** sufficient so as to achieve this.

Do retail margins vary for customers with differing consumption levels within the small customer class and/or location?

The profitability of customers may vary on the basis of customer class and or location. This is also true for customers with similar consumption levels across jurisdictions.

The greater the level of interaction required with the customer the more impact there is on retail margin. For example if you have two customers with the same consumption levels, on the same tariff structure, yet one requires a greater level of interaction or management due to items such as the application of concessions or additional general enquiries etc, then the retail margin gained for that customer will be less that that of the similar customer who has not required the same level of interaction.

In assessing QLD in the context of benchmarking against other jurisdictions consideration must be given to the fact that QLD is the only jurisdiction that has a *"Reticulated Natural Gas Rebate".*

Is there any consistency in retail margin allowance in other jurisdictions? What retail margin benchmark should apply?

Retail margins are calculated on a jurisdictional specific basis. This is required as each jurisdiction (currently) has its own nuances that need to be taken into consideration when determining the allowable retail margin.

The QLD jurisdiction is the only one that has a separate *"Reticulated Natural Gas Rebate"* the administration and management of this rebate adds to retailers operating costs, this additional cost is specific to the QLD market and therefore adds to a retailers operating costs but only for the QLD market. Additionally the regulatory & compliance regime of a market impacts a retailers operating costs as there are currently general areas of divergence between jurisdictions with regard to the regulatory and compliance regimes, which again adds to a retailers cost, therefore any level of consistency in determining appropriate retail margins across jurisdictions would be minimal at best.