**Hon Geoff Wilson MP**
Member for Ferny Grove

**Queensland Government**

**Minister for Mines and Energy**

Your Ref:
Our Ref: ME/08/1166, MBN452

30 APR 2008

QLD COMPETITION AUTHORITY

- 2 MAY 2008

DATE RECEIVED

Mr John Hall
Chief Executive Officer
Queensland Competition Authority
GPO Box 2257
BRISBANE QLD 4001

Dear Mr Hall

In my letter of 11 March 2008 regarding the Queensland Competition Authority's (QCA) draft decision on the benchmark retail cost index for electricity, I foreshadowed my intention to have the QCA investigate small customer gas pricing and competition in Queensland. I note that since that time, departmental officers have held a number of meetings with QCA officers to discuss this initiative, draft terms of reference and a proposed timeframe for the review.

I can now advise that on 2 May 2008 I will, by gazette notice, formally direct the QCA to undertake this investigation in accordance with my powers under section 227A of the *Gas Supply Act 2003*.

I have attached terms of reference which the QCA should address in conducting its investigation. In conducting this investigation, the QCA should invite submissions from stakeholders to the extent to which it considers necessary or desirable. I will expect to receive the QCA's report on its findings by 1 December 2008.

Should you have any enquiries about this direction they should in the first instance be directed to Ms Michelle Norris, Director - Energy Policy Division on telephone 3225 8256.

Yours sincerely

[redacted]

**GEOFF WILSON MP**
**Minister for Mines and Energy**

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# REVIEW OF SMALL CUSTOMER GAS PRICING AND COMPETITION IN QUEENSLAND

## TERMS OF REFERENCE

### Background

Deregulation of natural gas tariffs coincided with the start of Full Retail Competition (FRC) in gas on 1 July 2007. Deregulation allowed gas retailers to further move towards cost-reflective pricing which had initially commenced in 2005 with a number of increases in gas tariffs higher than the consumer price index. The aim of these policies is to encourage further development of the State's natural gas market. Gas prices for small customers were cross-subsidised and generally well below cost prior to 1 July 2007.

The move to cost reflectivity affected individual consumers differently. Depending on location, some household consumers with a gas cook top and hot water system faced a cost increase, whilst other customers may have experienced reductions in their gas bills.

However, some smaller residential customers (for example those with a cooktop only) experienced more significant price rises. The price changes had a greater impact on small gas users because fixed charges (including network and retail costs) now make up a larger proportion of their total gas bill, as retailers move to reflect the structure of the costs they face in retail pricing. Also, because of the high proportion of fixed charges in their bills, there is little scope for smaller customers to mitigate the increase by lowering consumption.

Looking forward, the gas retailers have not provided any firm indication of the likely increases still required to achieve cost-reflectivity in natural gas tariffs, or the price changes that may take place later in 2008 or later.

To help alleviate the difficulties faced by some smaller customers, on 16 October 2007 the Government announced a $55 per year rebate for eligible seniors and pensioners who have reticulated natural gas. This rebate was targeted at meeting a substantial part of the increase in fixed charges borne by those affected small customers least likely to be able to absorb the increase.

A number of additional Queensland Government initiatives have been implemented to assist residential gas customers and grow the residential gas market. These include the Sustainable Housing Code, Queensland Residential Gas Installation Rebate Scheme and the phase-out of electric hot water systems.

These initiatives have the potential to reduce gas prices to customers by spreading distribution costs over a growing customer base. The Queensland Government anticipates that, as customer numbers grow and the utilisation of the system improves, the average cost to the consumer will reduce over time. In addition, growth in the residential market may attract additional retailers into Queensland, increasing competition and potentially lowering prices.

Significant residential areas in Queensland do not have access to reticulated natural gas and many current gas customers use Liquefied Petroleum Gas (LPG), either through a reticulated network, or more commonly bottles. The price of LPG is set at world prices. Given the growing demand for LPG internationally, it is understood that the price of LPG is also increasing beyond the consumer price index annually.

In this context, it is timely for the Queensland Competition Authority (QCA) to undertake a Review of Small Customer Gas Pricing and Competition in Queensland.

The Queensland Government is currently developing a Queensland Residential Gas Market Strategy. The objective is that the outcomes of this Review will determine whether any additional measures need to be combined with existing initiatives, to improve competitive market outcomes for gas customers, incumbent retail market participants and new entrants.

**Head of Power**

The *Gas Supply Act 2003* includes the provision to enable Direction by the Minister to investigate a number of areas in relation to pricing and retail competition within the gas industry in Queensland.

Under Chapter 3, Part 4, Division 1, Section 227A the Minister may, by gazette notice, give the Queensland Competition Authority (QCA) a written direction to:

- investigate the effectiveness of retail competition in the Queensland retail gas market; and
- give the Minister a report on the pricing investigation within a stated period.

Under Chapter 5, Part 3, Section 270K, the Minister may, by gazette notice, give the QCA a written direction to conduct a review into:

- any matter relating to the Queensland reticulated processed natural gas markets.

**Objectives**

As Minister, I wish to ensure that consumers of gas in Queensland benefit from competition and efficiency in the market place. This includes reticulated natural gas and its alternatives, reticulated and bottled Liquefied Petroleum Gas (LPG).

Accordingly, I direct the QCA to undertake a Review of Small Customer Gas Pricing and Competition in Queensland.

This review should examine current market issues in the interests of gas customers, incumbent retail market participants and new entrants.

**Matters to be Considered**

In undertaking the Review of Small Customer Gas Pricing and Competition in Queensland, the QCA is to consider and report on the following issues:

1. The level of competition in the reticulated natural gas market, and as a comparison, other substitute fuels including reticulated and bottled LGP in Queensland. This should include an assessment of the following components:
   - Current competition within the small customer gas market (Refer to point 3);
   - Changes is market competitiveness over time, and the potential for future competition within the small customer gas market;
   - Ability of retailers to enter the market, including barriers to entry across the gas market supply chain, and expansion of the gas retail market;
   - Relevant gas market supply constraints; and
   - The impact of competition in the small customer gas market on the profitability of the reticulated natural gas distribution areas.

2. The impact of movements in upstream gas costs on the current prices paid by small customers including an assessment of:
   - Wholesale gas prices;
   - Transmission costs;
   - Distribution costs;
   - Retail operating costs; and
   - Retail margin.

   The QCA should consider movement of these costs over time, and the potential for future changes in costs.

   Based on the above outcomes, the QCA should provide comment on whether current Queensland small customer prices are reflective of the actual costs incurred in the upstream gas supply chain. If the QCA considers that prices are not cost reflective, the QCA should comment on the price adjustments necessary to achieve cost reflectivity.

3. Current small customer gas market activity, including:
   - The exercise of market choice and switching behaviour by consumers and any technical or other barriers to this;
   - Any impediments to small customers being able to exercise informed choices regarding their retailer of choice; and
   - The perceptions of natural gas as a product of choice in the small customer market compared to other energy supply options.

4. The QCA should consider how each of these issues affects different categories of small gas customer, for example, small commercial customers, domestic customers with a gas cooker only and domestic customers with a gas cooker and gas hot water system.

5. Where relevant, the QCA should comment on differences in market competitiveness and cost reflectivity between regions within Queensland.

6. The QCA should provide analysis of differences in market competitiveness and cost reflectivity between Queensland and other Australian States or Territories.

This should include consideration of other recent reviews of gas pricing and competition in other jurisdictions or nationally, where relevant to this Review.

Any other issues not explicitly mentioned here which arise during the course of the Review, and which impact on the Review's objectives or matters being considered, should, where relevant, be included in the report to the Minister.

**Definitions**

For the purpose of this Review, a "small customer" is consistent with that defined in the *Gas Supply Regulation 2007* as one consuming less than 1 terajoule of gas per annum per connection.

**Consultation**

In conducting this review, the QCA is requested to invite submissions from stakeholders to the extent to which it considers necessary or desirable.

**Reporting Period**

The QCA must submit its report on its Review of Small Customer Gas Pricing and Competition in Queensland in its final form to the Minister no later than 1 December 2008.