Economic Regulation Authority

Notice

21 October 2016

Effectiveness of regulatory scheme for Synergy

The Economic Regulation Authority (**ERA**) has published its report on the regulatory scheme for Synergy.

The wholesale electricity market is a relatively small market with significant concentration in the supply of energy. Synergy controls three quarters of wholesale energy supplied in the South West. Consequently, measures to mitigate Synergy's market power are necessary when it contracts with third parties and to ensure only efficient costs are passed through to consumers.

The Western Australian Government established a regulatory scheme to mitigate Synergy's market power when it merged Verve Energy and Synergy on 1 January 2014. The ERA is responsible for assessing the effectiveness of the scheme.

In its review, the ERA has focussed on whether market participants have access to forward energy contracts on fair and reasonable terms. Typically, electricity retailers manage their price risks by entering into forward energy contracts to lock in future energy prices. Otherwise, they are exposed to short-term price variations in energy markets.

Currently, excess baseload generation capacity has resulted in relatively low and stable prices in the short-term energy market and balancing market, as generators have sought to sell surplus energy. Consequently, retailers have had less need of forward energy contracts.

This is likely to change in future. The Government's Electricity Market Review is introducing reforms that will reduce excess capacity in the Wholesale Electricity Market. Prices in the short-term energy market and balancing market are likely to become more volatile as excess capacity falls. Retailers will be more likely to need forward energy contracts to manage the risks caused by price variations.

The scheme requires Synergy to offer standard energy contracts to buy and sell energy in the future, with the spread between the price to buy and sell energy specified in the scheme. The scheme specifies the difference between the sell and buy prices to encourage Synergy not to set its "sell price" too high, because if it does it may also have to buy energy at higher prices. The ERA considers that the current spread of 20 per cent is too wide to ensure that Synergy's standard contract prices reflect a competitive benchmark price.

The ERA's main recommendations are to:

- reduce the spread to ensure Synergy's published standard energy contracts provide a competitive benchmark price for energy contracts, helping retailers to hedge future price risks; and
- improve the transparency of Synergy's financial reporting to provide confidence there are no cross subsidies between Synergy's businesses.

The Government has announced that it will open up the remainder of the electricity market to retail competition. Measures like this scheme that mitigate market power, and rules prohibiting generators from offering prices above their short run marginal cost, will still be needed to ensure only efficient costs are passed through to consumers until the wholesale and retail markets are more competitive.

A copy of the report is available on the ERA's website.

For further information contact:

General Enquiries
Elizabeth Walters
Phone: 08 6557 7958
Email: records@erawa.com.au

Media Enquiries
Tracy Wealleans
Work: 08 6557 7942
Mobile: 0428 859 826
Email: communications@erawa.com.au