

Issues Paper

Review of the REMCo Gas Retail Market Scheme

20 August 2007

Economic Regulation Authority



WESTERN AUSTRALIA

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Executive Summary

The Economic Regulation Authority (Authority) administers gas retail market schemes in accordance with Part 2B of the *Energy Coordination Act 1994* (Act). The Authority is required to undertake a review of gas retail market schemes as soon as practicable after the third anniversary of their commencement.

The object of a review is to re-assess the suitability of provisions of a retail market scheme for the purposes of section 11ZOB of the Act.

The Retail Energy Market Company (REMCo) gas Retail Market Scheme (RMS) is now due for review. This issues paper has been prepared to facilitate submissions from interested parties during the consultation phases of the review.

This issues paper identifies a number of key issues relating to the REMCo gas RMS, as follows:

- operation of the Retail Market Rules;
- the Rule Change Process;
- the Compliance Process; and
- Swing Service Pricing.

Another issue which has been raised in this paper concerns the development of the national gas market reforms. The Council of Australian Governments has endorsed a proposal to create a National Energy Market Operator (NEMO) which would be expected to subsume the gas market functions of REMCo and the gas retail market administrators in the Eastern States. NEMO is proposed to operate from mid 2009.

Public Submissions

The Authority invites submissions from interested parties. Questions are raised throughout the paper and interested parties are invited to comment on any of the issues they consider relevant to the review.

All submissions should be in electronic and hard copy form and must be received by **4:00pm (Western Standard Time) on Friday 28 September 2007**.

Written submissions should be mailed to:

Mr Lyndon Rowe
Chairman
Economic Regulation Authority
PO Box 8469
Perth BC WA 6849

Electronic submissions should be made to: michael.styles@era.wa.gov.au.

In general, all submissions from interested parties will be treated as in the public domain and placed on the Authority's web site.

Where an interested party wishes to make a submission in confidence, it should clearly indicate the parts of the submission for which confidentiality is claimed and specify in reasonable detail the basis for the claim.

The publication of a submission on the Authority's web site shall not be taken as indicating that the Authority has knowledge either actual or constructive of the contents of a particular submission and, in particular, whether the submission in whole or part contains information of a confidential nature and no duty of confidence will arise for the Authority.

Further information regarding this review can be obtained from:

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Introduction

The Economic Regulation Authority is responsible for the economic regulation of the Western Australian gas market which includes administering the Retail Energy Market Company Limited (REMCo) gas Retail Market Scheme (RMS) in Western Australia. REMCo is the gas retail market administrator for South Australia and Western Australia.

The scheme commenced operation on 31 May 2004 and was part of the gas Full Retail Contestability (FRC) reforms announced by the then Minister for Energy.

1.1 Requirement for Review

The Authority currently administers Part 2B of the *Energy Coordination Act 1994* (Act) which deals with the implementation and operation of gas retail market schemes.

Section 11ZOB of the Act states –

The purpose of a retail market scheme for a distribution system is to ensure that the retail gas market that is supplied through that system is regulated and operated in a manner that is:

- (a) open and competitive;
- (b) efficient; and
- (c) fair to gas market participants and their customers.

Under section 11ZOQ of the Act, the Authority is required to carry out a review of a retail market scheme as soon as is practicable after the third anniversary of its commencement. The REMCo RMS commenced on 31 May 2004.

The object of the review is to re-assess the suitability of provisions of a retail market scheme for the purposes of section 11ZOB of the Act.

1.2 Review Process

The review process proposed for the REMCo gas RMS is as follows:

- 20 August 2007 – Release of issues paper with six week public consultation period.
- 28 September 2007 – End of first round of public consultation.
- Mid November 2007 – Release of draft report with four week public consultation period.
- Mid December 2007 – End of second round of public consultation.
- Mid February - Release of final report.

2 How the REMCo Gas RMS Works

2.1 What the REMCo Gas RMS is

Practical deregulation of the retail gas market in Western Australia occurred on 31 May 2004. The then Minister for Energy introduced a number of new mechanisms to protect small use customers in the new retail gas market. These included:

- the Gas Industry Ombudsman Scheme;
- the Gas Marketing Code of Conduct;
- regulations for standard form and non standard contracts; and
- regulations to establish supplier of last resort arrangements.

The Economic Regulation Authority assumed responsibility for these mechanisms on 31 May 2004.

In addition to the above, a mechanism was also required to provide for churn where small use customers are able to change their gas retailer whenever they wish. This mechanism was a gas retail market scheme. A gas retail market scheme is a scheme that enables a retail market administrator to manage the gas market. A scheme must cover the process of customer transfers, as well as the balancing, allocation and reconciliation of the gas market.

Gas retail market schemes are an effective way of ensuring that gas retail markets are regulated and operate in a manner that is open and competitive, efficient and fair to gas market participants and their customers.

REMCo was established as the independent administrator of the gas retail markets in South Australia and Western Australia. Its aim is to develop and operate cost effective and efficient retail market arrangements for the gas industry, which are fair and equitable, to facilitate competition in the gas retail market, in both South Australia and Western Australia.

The REMCo gas RMS was the first gas retail market scheme in Australia involving a cooperative arrangement between two gas markets in different States. Without the cooperation between these two jurisdictions, it would have been difficult to provide a cost effective gas retail market scheme for either South Australia or Western Australia.

The REMCo gas RMS has operated since 31 May 2004. Responsibility for the REMCo gas RMS transferred to the Economic Regulation Authority on 31 May 2005.

There are three major components of the REMCo gas RMS as follows:

- an agreement between gas market participants (the REMCo Constitution);
- a market administrator (in this case REMCo); and
- a set of Retail Market Rules.

2.2 Elements of the REMCo Scheme

There are four elements of the REMCo gas RMS. These are the REMCo constitution, the Retail Market Rules, the Specification Pack and the FRC Hub conditions.

2.2.1 *REMCo Constitution*

The REMCo Constitution is an agreement signed by all REMCo members and binds all the REMCO members to comply with the Rules and also sets out how REMCo will operate under the Corporations Act 2001.

2.2.2 *Retail Market Rules*

The purpose of the Retail Market Rules is to govern the major interactions between gas retailers, pipeline operators, prescribed persons (under the Act) and REMCo in the gas retail markets of South Australia and Western Australia.

2.2.3 *Specification Pack*

The Specification Pack provides technical details of how REMCo, gas market participants, pipeliners and prescribed persons are to build and operate the IT systems to implement the rules.

2.2.4 *FRC Hub Conditions*

The FRC Hub Conditions are the conditions that the hub is to be operated under. REMCo has a Hub Services Agreement with the National Electricity Market Management Company (NEMMCO) who is the Hub Services provider to REMCo. The REMCo FRC Hub conditions are required to be met as part of the services agreement and mirror NEMMCO's own Hub Operator Conditions.

2.3 How the REMCo Gas RMS Operates

The four primary business processes that REMCo operates are:

- Delivery point management – managing the transfer of responsibility for gas delivery points between retailers;
- Balancing, Allocation and Reconciliation Management – managing the daily allocation of gas usage to retailers to enable settlement of gas supply and transmission contracts;
- Rules Change Management – managing further development and improvement of the rules governing the operation of the retail gas markets; and
- Compliance management – managing and enforcing compliance with the rules governing the operation of the retail gas market.

3 Major Issues for Review

3.1.1 *Operation of Retail Market Rules*

The Authority is aware that REMCo is currently undertaking a Rule 17 review of the Retail Market Rules. The results of the REMCo Rule 17 review will become available to the Authority and will form part of its review process. Notwithstanding the Rule 17 review, interested parties are invited to raise any issues or problems involving the operation of the Retail Market Rules.

Issues

- 1) Are stakeholders happy with the operation of the Retail Market Rules?
- 2) Are there any suggestions for further improvement?

3.1.2 *Rule Change Process*

The rule change process is a consultative and inclusive process designed to ensure that any change to the Retail Market Rules, the REMCo Specification Pack or the FRC Hub Conditions is developed and implemented in a controlled and agreed fashion. All relevant stakeholders in any rule change are provided with the opportunity to influence the development of a rule change before REMCo submits the rule change to the relevant jurisdictional authority for approval.

The Rule Change Committee oversees the operation of the rule change process on the basis of the following objectives:

1. to ensure that retail gas markets operate in a manner that is:
 - (a) open and competitive;
 - (b) efficient; and
 - (c) fair to participants and their customers;
2. to ensure compliance with all applicable laws;
3. to ensure that no jurisdiction is advantaged or disadvantaged in comparison to the other jurisdiction; and
4. to ensure consultation with all participants, pipeline owners, prescribed persons and interested persons as is reasonably required to meet the objectives of REMCo.

Approximately 48 rule changes were considered by the Rule Change Committee in the first 12 months after the operation of the SA and WA gas markets. Many of these rule changes dealt with matters that were identified in the final stages of the development of gas markets prior to go-live but could not be completed due to the deadline for meeting the market go-live dates. In each subsequent year the number of rule changes has declined as the operation of the market has become better understood.

In 2005 one of these rule changes included a change to the previous rule change process to allow rule changes to progress more efficiently through the rule change process.

The changes were:

- Streamlining of the reporting provisions;
- Introduction of a new category of rule change – non-substantial amendments that would not require any market consultation (REMCo would implement an operational procedure to provide changes to the market for review for a period of 5 business days during the rule change process prior to submission of any non-substantial amendments to jurisdictions);
- Changes to the low impact rule change process – the consultation period would be shortened from 20 business days to 10 business days and called an ‘objection period’. If no objections are received for a low impact rule change then the change would be recommended for submission to the jurisdictions directly; and
- Changes to the high impact rule change process – the consultation period would be shortened from two 20 day business periods to one 10 business day and one 20 business day consultation period. Further, if non material changes were made to an endorsed rule change after consultation, it would not be required to undergo further consultation and if material changes were made to an endorsed rule change it would be provided for a 10 business day consultation instead of another 20 business days.

A flow chart outlining the new rule change process is provided in Appendix 1.

Issues

- 1) Are stakeholders happy with the operation of the rule change process?
- 2) Are there any suggestions for further improvement?

3.1.3 Compliance Process

The compliance and rules interpretation process governs the activities associated with the resolution of apparent rule breaches and requests for the proper clarification of the Retail Market Rules.

The process must be:

- transparent, fair and equitable to all parties;
- encourage market participants to comply with the Rules;
- provide appropriate sanction to market participants who are found to have committed a material breach of the Rules; and
- provide jurisdictions with sufficient reliable information to determine any further action relevant under law, Regulation or Licence provision.

The process is administered by REMCo in accordance with Chapter 6 of the Retail Market Rules and the REMCo (Board) Compliance Procedures document.

To ensure independent consideration, all alleged breaches and requests for rule interpretations that are considered to be material are referred to the independent Compliance Panel.

The functions of the Compliance Panel are to hear and make determinations on matters referred to it by REMCo or a participant regarding:

1. alleged breaches of the Retail Market Rules;
2. the interpretation of the Retail Market Rules; or
3. any other matter in relation to the Retail Market Rules.

The Compliance Panel has the power to:

1. request a participant of REMCo to provide information relevant to a matter being considered by the Compliance Panel;
2. make a determination on matters referred to it under the Retail Market Rules;
3. make orders in accordance with the Retail Market Rules; and
4. in order to assist in fulfilling its functions:
 - (a) appoint a person performing the functions of REMCo, any officer or employee of that person or such other person as the Compliance Panel thinks fit, to act as an agent of the Compliance Panel in carrying out investigations or other functions; or
 - (b) employ, or otherwise seek advice or assistance from, an external investigator, auditor, accountant, lawyer, or other expert, or such other person as the Compliance Panel thinks fit, provided that in appointing a person the Compliance Panel must ensure that the person does not have a conflict of interest.

Only one major compliance issue has occurred since the commencement of the operation of REMCo and this related to a self contracting matter in the South Australian gas retail market.

In 2006 REMCo conducted a review of the compliance process and subsequently a rule change was made to improve the handling of alleged breaches, make changes to the arrangements for costs on withdrawal of a Compliance Panel complaint to discourage frivolous or vexatious referrals and remove the dispute resolution process in chapter 6 of the Retail Market Rules which was unenforceable.

The changes to the breach handling process were:

- all apparent breaches that REMCo becomes aware of would be published to all participants as they arise;
- participants would have 30 business days within which to raise a material breach allegation;
- no further action would be taken in relation to these apparent breaches unless a participant alleged that an apparent breach was material;

- each month REMCo would produce a summary report of the apparent breaches for the month and the closing date by which any material breach allegations must be raised;
- an apparent breach would be considered by REMCo under the Rules only if a participant alleged it was a material breach;
- submissions would be sought in relation to an apparent breach only if a participant alleged it was a material breach;
- when REMCo is the respondent, the Board will take no further action if REMCo admits the breach and the Board determines that the matter was not material. However, if the matter is material, or if REMCo does not admit the breach, the matter would be referred to the Compliance Panel;
- when a participant is the respondent, REMCo will resolve that no further action will be taken if REMCo considers that the matter did not have a material impact on the market or an affected participant, otherwise REMCo will refer the matter to the Compliance Panel;
- overall, REMCo would consider significantly fewer breaches; and
- consequently the cost of the compliance process to both REMCo and participants would be reduced.

A flow chart outlining the new compliance process for alleged breaches of the rules is provided in Appendix 2.

Issues

- 1) Are stakeholders happy with the operation of the compliance process?
- 2) Are there any suggestions for further improvement?

3.1.4 *Swing Service Pricing*

Swing service was incorporated into the Retail Market Rules to facilitate balancing, allocation and reconciliation when a sub network is supplied by more than one pipeline.

REMCo administers swing service which is the balancing mechanism for the gas supplied into sub-networks supplied by more than one pipeline. The Market Rules are used to calculate which network users have not delivered into the network the exact quantity of gas consumed by their customers and the imbalances that result which are termed swing service. In the current methodology and situation, the aggregate of swing service on deliveries from one pipeline is the equal and opposite of the aggregate on deliveries from a second pipeline.

Users are entitled to enter into bi-lateral contracts with swing service providers to arrange contract cover for their daily swing service exposure. When a user has arranged an 'off-market' swing service contract and the user has notified this to REMCo and the counter party has confirmed the arrangement, REMCo will acknowledge this arrangement and not include the amount of the user's swing service that is covered by off-market arrangements in the swing service settlement that is settled against the swing service bid stack. All

swing service that is not covered by an off-market arrangement is settled in the swing service bid stack.

Swing service providers submit bids to REMCo for supply of quantities of swing service at a set price. The bid stack operates as a classic commodity bid stack with the bid at which supply matches demand setting the marginal clearing price at which all swing service that is settled via the bid stack is cleared.

To ensure that there is on-market coverage for swing service, REMCo has entered into a Swing Service Supplier of Last Resort (SSPOLR) arrangement with a swing service provider on each of the pipelines. When the swing service amount on a day is such that all other bids have been exhausted, the SSPOLR bid is the final bid in the bid stack and this sets the price for settlement of on-market swing service for the day.

In 2005 when the Authority took over responsibility for the REMCo gas RMS high swing service prices had become an issue in Western Australia. Australian Pipeline Trust (APT) was the only swing service provider on the Parmelia Pipeline and had off market arrangements with Western Power Corporation. Alinta Sales was the only swing service provider on the Dampier to Bunbury Natural Gas Pipeline. Alinta Sales had not been able to procure an off market swing service arrangement on the Parmelia Pipeline and had been forced to purchase all of its swing service on market from APT at prices which were considered by Alinta Sales to be excessive.

It was generally recognised that the swing service rules represented an imperfect compromise to the commercial tensions that existed when the rules were being developed. REMCo investigated alternative methods to resolve the high swing service prices. Out of this modelling exercise, in return for a change to the Market Rules to a simpler methodology, Alinta Sales offered to provide daily swing service amounts up to 0.5 TJ at no cost on the Dampier to Bunbury Natural Gas Pipeline thereby providing the market with a lower overall cost solution.

At the time there were also very high swing service prices in South Australia but with the expected changes as a result of the national gas market reforms it was decided on a cost/benefit basis not to alter the existing arrangements in either jurisdiction. Since this time swing service prices in Western Australia have generally remained lower under the existing arrangements and volumes have averaged approximately 150 GJ each day during 2006/07.

Issues

- 1) Are stakeholders happy with the current swing service arrangements and prices?
- 2) Are there any suggestions for further improvement?

4 Future National Reforms and their Impact on the Operation of REMCo

4.1.1 *Planned National Gas Market Reforms*

At its meeting on 13 April 2007, the Council of Australian Governments (COAG) endorsed a number of recommendations developed by the Energy Reform Implementation Group (ERIG). As part of its commitment to the ERIG proposals, COAG has agreed to establish a single industry funded National Energy Market Operator (NEMO), for both electricity and gas, to strengthen the national character of energy market governance. COAG has requested the Ministerial Council on Energy (MCE) to develop, in consultation with stakeholders, a detailed implementation plan by the end of 2007 for establishing the NEMO.

COAG noted that the creation of the NEMO recognised the convergence of regulatory frameworks for gas and electricity as well as the economies of scale and scope arising from a single interface with energy industry participants.

The NEMO's functions will include responsibility for the planned Gas Market Operator (GMO) with the MCE to advise COAG on the necessary requirements for staging the establishment process for the NEMO, based on consultation with stakeholders.

The GMO would be expected to subsume the gas market functions of VENCORP, the Gas Market Company and REMCo, subject to agreement by the relevant states, and to have responsibility for the operation of a bulletin board and short term trading market for gas.

A timetable of mid-2009 has been set for establishment of the NEMO.

Issues

- 1) Do stakeholders have any comments in relation to the potential transfer of REMCo's functions into the NEMO?
- 2) Are there any improvements which could be made to the structure or operation of REMCo to facilitate the potential transfer of REMCo's functions into the NEMO?

4.1.2 *Other Issues*

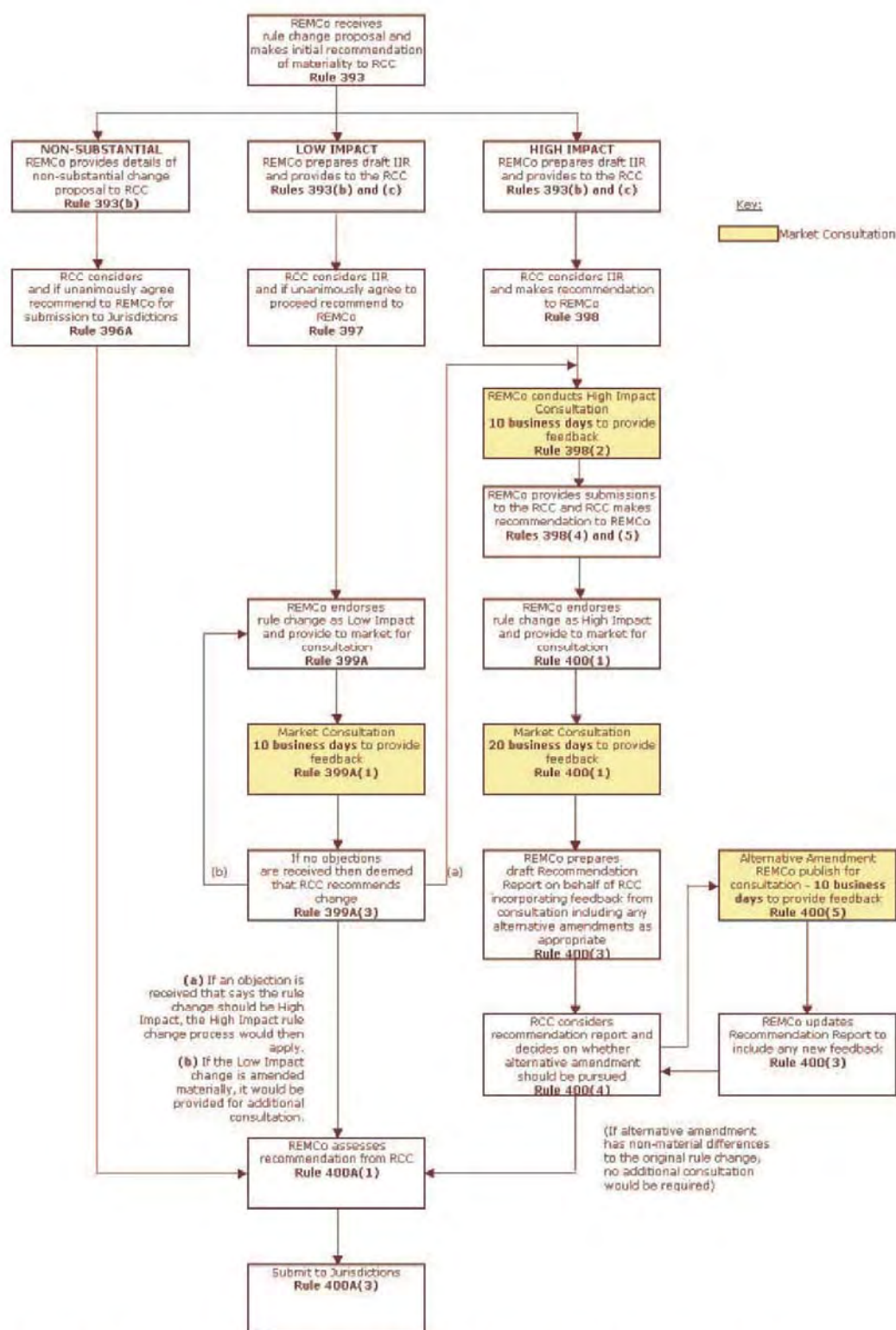
The Authority is not aware of any other issues in relation to the operation of the REMCo gas RMS. However, if there are any other issues involving the operation of this scheme interested parties are invited to raise such issues.

Issues

Are there any other issues that stakeholders would like to raise concerning the operation of the scheme?

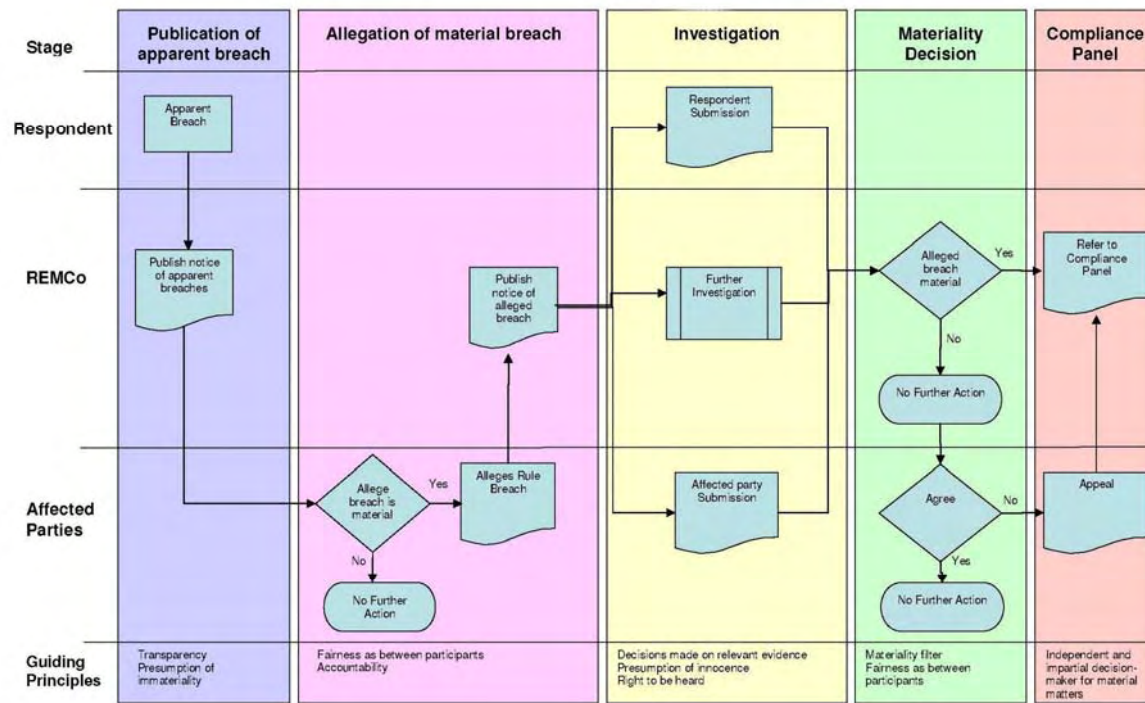
APPENDICES

Appendix 1 Flow Chart Representing the Rule Change Process



(Please note the main steps in the process have been represented only)
(Source: REMCo)

Appendix 2 Flow Chart Representing the Compliance Process for Alleged Breaches of the Rules



(Source: REMCo)