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Dear Lyndon

REVIEW OF THE REMCO GAS RETAIL MARKET SCHEME

Thank you for the opportunity to comment on the Authority's discussion paper *Review of the REMCo Gas Retail Market Scheme*.

Synergy endorses attempts to create a National Energy Market Operator (NEMO) and, in so doing, reduce the regulatory and administrative burdens currently incurred by industry participants.

However, given the relative isolation and uniqueness of Western Australia's wholesale electricity and gas markets, it may be preferable to create a Western Australian Market Operator (WAMO) as a transitional step, with this being subsequently absorbed by NEMO at some later date.

Yours faithfully

GRANT DRAPER
HEAD OF STRATEGIC BUSINESS

INTRODUCTION

Synergy welcomes the opportunity to comment on the Authority's review of the Retail Energy Market Company (REMCo) Gas Retail Market Scheme. We note that the issues paper released in August 2007 highlights some matters associated with the current Market Rules for discussion, most notably:

- Operation of the Retail Market Rules (Rules);
- The Rule Change Process;
- The Compliance Process; and
- Swing Service Pricing.

In addition to this, the Authority has asked for comment on the potential development of national gas market reforms and the Council of Australian Governments (COAG) endorsement of a National Energy Market Operator (NEMO). NEMO is proposed to operate from mid 2009 and would subsume the gas market functions currently undertaken by REMCo.

Synergy addresses these matters separately below.

OPERATION OF CURRENT MARKET RULES

Synergy notes the release, on 25 September 2007, of REMCo's report titled "Report on Rule 17 Review of Retail Market Rules". This report is mandated under REMCo Rule 17, where REMCo is required to undertake a review of the Retail Market Rules. We note that the report concluded:

- The gas markets in South Australia and Western Australia are operating largely to the satisfaction of the participants involved; and
- The changes being pursued under the national gas market initiatives (overseen by the Gas Market Leaders Group) are considered to be sufficient to address any operating issues in the South Australian and Western Australia gas markets.

Synergy, in the main, supports this assessment.

OPERATION OF THE RETAIL MARKET RULES

- Are stakeholders happy with the operation of the Retail Market Rules?

While gas Full Retail Contestability (FRC) has been in place in Western Australia since May 2004, lack of significant secondary gas retailers (in terms of number of customers and volumes of sales) implies that the full operation of the Market Rules is yet to be experienced. The adequacy of institutional arrangements in this jurisdiction are therefore yet to be put to the test. This is likely to only occur should a new, small use, gas market retailer enter the market, either by way of a new market entrant or the removal of the moratorium currently prohibiting Synergy from retailing gas to customers with an annual consumption below 180GJ.

Notwithstanding this, at present Synergy identifies no significant concerns with the operation of the Retail Market Rules.

OPERATION OF THE RULE CHANGE PROCESS

- Are stakeholders happy with the operation of the Rule Change Process?

Synergy's sees the Rule Change Process as working well and that it has been suitably responsive to the needs of participants.

- Are there any suggestions for further improvement?

Synergy makes no suggestions for further improvement of the Rule Change Process.

COMPLIANCE PROCESS

- Are stakeholders happy with the operation of the Compliance Process?

Synergy's view is that the Compliance Process is operating at a satisfactory level.

- Are there any suggestions for further improvement?

Synergy makes no suggestions for further improvement of the operation of the Compliance Process.

SWING SERVICE PRICING

- Are stakeholders happy with the current Swing Service arrangements and pricing?

Synergy believes that while Swing Service Arrangements are complex, they enable the market to manage gas inputs into a retail network supplied by multiple pipelines. Synergy notes that this arrangement has been the subject of substantial discussion in recent periods, with a growing consensus that Swing Service Arrangements provide stable and cost-effective supply for retailers. Synergy supports this view and highlights the need for both REMCo and the Authority to undertake training and education sessions to promote understanding of Swing Service arrangements.

- Are there any suggestions for further improvement?

Synergy has previously highlighted that the basis of carriage should be a hybrid or contract carriage for foundation shippers and market carriage for retail shippers. Synergy acknowledges that this would require a fundamental change in the Retail Market Rules and general market conditions, however we hold that this may potentially lead to a more effective swing service mechanism and improved pricing outcomes for retailers and their end-use customers.

FUTURE NATIONAL REFORMS AND THEIR IMPACT ON REMCO'S OPERATION

- Do stakeholders have any comments in relation to the potential transfer of REMCo's functions into the NEMO?

Synergy notes that on 13 April 2007, COAG endorsed a recommendation by the Energy Reform Implementation Group (ERIG) to establish a single, industry-funded, National Energy Market Operator (NEMO). It is envisaged that NEMO will bring together the operations of the three separate entities, VENCORP, GMC and REMCo (in addition to the activities of the various electricity market operators).

Synergy identifies some clear economic advantages to the Western Australian gas market in relation to the transfer of REMCo's functions into NEMO, including:

- The potential for decreased costs due to more efficient operation of the market, likely economies of scale arising from common information technology systems for gas and electricity (for market operation, system monitoring and information gathering) and a likely decrease in regulatory and market compliance work.
- More efficient outcomes for the energy market arising from information sharing and leading to an improved understanding of fuel supply, and most notably the critical interactions between gas and electricity supply.
- The transfer of REMCo's functions into the NEMO are a decrease in regulatory barriers to entry for Eastern States based energy retailers who may want to enter the Western Australian gas retail market. A common market operator would allow potential market entrants to better benchmark the Western Australian Retail Gas Market to the Eastern States gas markets. This is especially relevant since there has been a limited entry by retailers into the Western Australian gas market since the implementation of FRC in that market in 2004. In the longer term, this may also allow Western Australian energy retailers to enter the Eastern States gas markets. The reduction of these barriers to entry is clearly consistent with National Competition Policy Principles.

Synergy notes that the REMCO Rule 17 Report indicates most Western Australian based REMCo stakeholders are satisfied with the operation and structure of market operator. To this end, as a precondition of Synergy's support for the transfer of REMCo's functions into the NEMO, key risks and issues that would need to be addressed include:

- The market structure in Western Australia is different to the Eastern States at all levels of the supply chain. These differences include the lack of an interconnected pipeline network with other States, the lack of multiple energy retailers and the constrained nature of gas supply placing significant upward pressure on energy prices. Synergy believes that the rules relating to the operation of NEMO should be adaptable to the Western Australian Retail Gas Market with minimal cost of regulatory compliance for stakeholders operating or planning to operate in Western Australia.
- At present, stakeholders at all levels of the Western Australia gas market feel there is sufficient representation and engagement in interactions with REMCo. Synergy believes that the level of representation and engagement has been a key factor in the level of satisfaction with REMCo's operation. There is a risk this would no longer be the case if REMCo's functions are transferred to the NEMO.
- There were significant costs to various parties associated with the implementation of REMCo. Similar costs can be expected if REMCo's functions are transferred to the NEMO. It is Synergy's view that the cost of implementing the transfer should not exceed the benefits.
- There were significant costs associated with the establishment of REMCo. These costs have not reached their payback horizon and stakeholders in both Western Australia and South Australia would need to include them in their cost-benefit analysis.

As such, while Synergy supports the long term aspiration by COAG to move to a single national electricity and gas market operator, this support is subject to the above concerns being adequately addressed.

Synergy recognises that, for the Western Australian energy market (which includes REMCo) there are two possible paths to achieving the longer term objective of a national energy market operator:

- The immediate integration of Western Australian energy market operations into national energy market operator; or
- The creation of a Western Australian energy market operator with a view to consider the integration of this operator into a national energy market operator in the longer term.

Synergy notes that the first option has been considered by the Gas Market Leadership Group who have recently developed a Gas Industry Development Plan which recommends the creation of a single gas market operator, bringing together the operations of the three separate entities, - VENCORP, GMC and REMCo.

Synergy has established the following perspectives on the WA energy market:

- The Western Australian energy markets are physically and structurally different from the Eastern States markets. This implies that setting up a national market operator which is flexible enough to cater for the Western Australia as well as the Eastern States would result in further regulatory complexity at significant financial and time costs to the local energy market. The local energy market is already constrained at present with the level of regulatory and market compliance related activities.
- Greater separation of regulatory and market operation roles is required in the Western Australian energy market, this requires further reform prior to the state becoming ready for moves to integrate with a national energy market operator.
- The establishment of a single market operator in Western Australia would be a relatively easier task to achieve than in the Eastern States. This would allow implementation in a shorter timeframe than would otherwise be possible and this implementation could be a test case for the viability of a single market operator in Australia.
- At present, there is no formal retail electricity market operator in Western Australia, with most of these functions being carried out informally by Western Power. It is likely that introduction of FRC in the electricity would see the establishment of an electricity retail market operator. This would again increase the number of market operators in Western Australia, creating an additional regulatory and market compliance burden on the local energy market.

We also note the substantial level of industry change experienced in recent years in Western Australia, the scale of institutional arrangements yet to be put in place to enable Full Retail Contestability for electricity and the current barriers to effective gas retail competition arising from the domestic gas supply constraints in Western Australia, Synergy views it as important that a staged approach to market reform is adopted. This will go some way towards ensuring that any gains achieved to date in promoting competition are locked in before a substantial and potentially disruptive shift in industry structure is advanced.

Synergy has a strong reference for the creation of an industry-based market operator, operating under a model similar to that of REMCo. Under this model Government is responsible for policy and instruments, with industry itself responsible for implementation and operation of the market. This operator, should be self funding, remaining independent of individual industry participants. In our experience, an industry-based operator, such as REMCo, is more responsive to industry needs. In consideration of these matters, Synergy believes that it would be more appropriate to transition Western Power's functions into a REMCo model, thereby creating a new State-based gas and electricity market operator, with an established longer-term objective of integrating this operator into a national energy market operator. Chart 1 describes the concept and scope of a Western Australia Market Operator (WAMO).

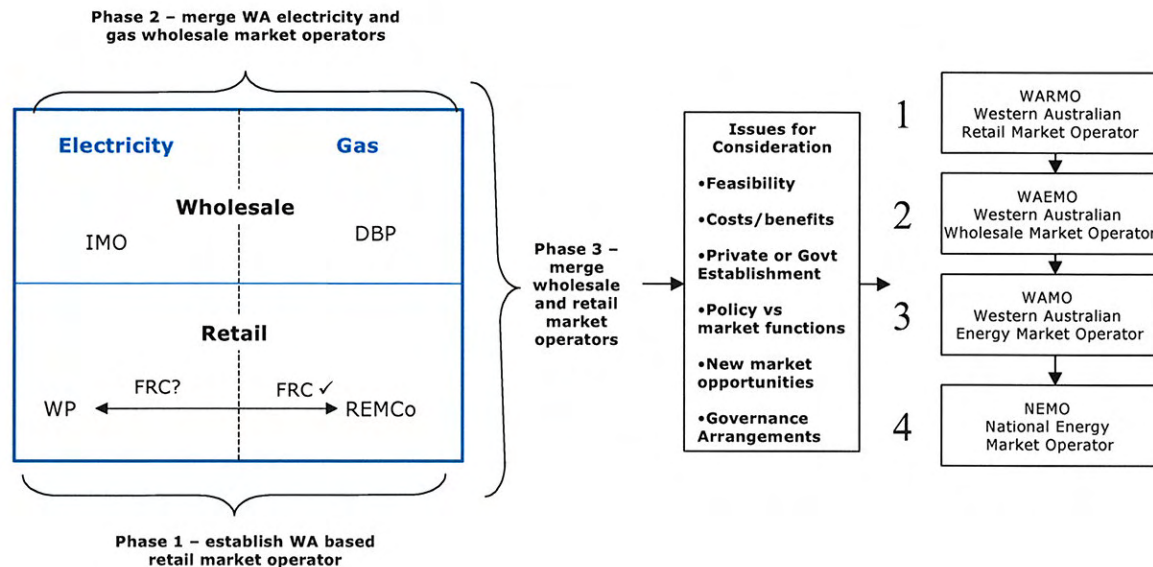


Chart 1: Streamlining Western Australian Energy Market operation

Synergy sees the move to a single Western Australian Market Operator as being best achieved through a phased approach:

- Phase 1 – establish an industry operated and funded retail market operator, along the lines of REMCO – to be implemented as part of the move to electricity FRC, with consistent retail market systems and processes applied to both the gas and electricity markets. Synergy recommends that in the first instance REMCo would subsume the current Western Power systems and processes.
- Phase 2 – merge the existing gas and electricity wholesale market operators – as a reflection of the relative infancy of the Wholesale Electricity Market (WEM) this would only occur as the outworking of detailed assessment and is unlikely to occur in the near term.
- Phase 3 – merge the state-based retail and wholesale market operators.
- Phase 4 – merge the single State-based operator (WAMO) with the single national operator (NEMO).

- 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?

Aside from comments elsewhere in the paper to this end, Synergy is satisfied that further changes to REMCo's structure are not necessary to facilitate the potential transfer of REMCo's functions into the NEMO.

OTHER ISSUES

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

Synergy proposes that as part of its Review, the Authority should consider working with the Office of Energy (OOE) in relation to its review of the operation and effectiveness of the Tariff Regulations. Synergy believes that the outcomes of both review processes will have a material impact on the structure of energy markets in Western Australia and as such the reviews should be conducted in a manner that ensures an optimal outcome.