

Draft Report

Review of the REMCo Gas Retail Market Scheme

2 January 2008

Economic Regulation Authority

 WESTERN AUSTRALIA

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Executive Summary

The Retail Energy Market Company (**REMCo**) Gas Retail Market Scheme (**RMS**) commenced operation on 31 May 2004. Under the *Energy Coordination Act 1994 (Act)*, a review of the REMCo gas RMS is required to be undertaken after the third anniversary of operation of the scheme. Pursuant to this Act, the Economic Regulation Authority (**Authority**), as the scheme administrator, is required to undertake this review.

On 20 August 2007, the Authority commenced the review with the release of an Issues Paper. This Issues Paper identified a number of key issues relating to the operation of the REMCo gas RMS. The Issues Paper was prepared to facilitate submissions from interested parties during the consultation phase of the review. Interested parties were provided with a six week period to make submissions on the Issues Paper.

Five submissions were received on the Issues Paper. These submissions were from Alinta Sales Pty Ltd, the APA Group, Dampier Bunbury Pipeline, the Office of Energy and Synergy. These submissions have been placed on the Authority's web site www.era.wa.gov.au.

Following consideration of the above submissions and taking into account the results of REMCo's Rule 17 Review, the Authority's draft conclusions and recommendations are as follows:

Conclusions and Recommendations

Conclusions

All the submissions received by the Authority indicated general support for the manner in which the REMCo gas RMS is currently operating. This was consistent with the result of REMCo's Rule 17 review of the operation of the Retail Market Rules which found that the gas retail markets in South Australia and Western Australia were largely operating to the satisfaction of participants involved.

The Authority concludes that the REMCo gas RMS is currently operating satisfactorily and that no changes to the provisions of the scheme to achieve the purposes set out in section 11ZOB of the Act appear to be warranted.

Recommendations

Based on the discussion outlined under Section 4.3 in this report, the Authority considers that REMCo should address the training needs expressed by market participants in relation to the swing service rules in the interests of ensuring that the REMCo gas RMS meets the requirements outlined under section 11ZOB of the Act.

The Authority recommends that REMCo should address the training needs expressed by a number of market participants in relation to the swing service rules, by arranging for a suitable training provider to provide the required training on appropriate commercial terms.

Next Stage

Subsequent to the issue of this Draft Report and the completion of the public comment period on the report, the Authority will prepare and issue a Final Report. The Final report is anticipated to be issued in March 2008.

1 Introduction

The Economic Regulation Authority (**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.

2 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 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.

3 Background

3.1 Establishment of the REMCo Gas RMS

Practical deregulation of the retail gas market in Western Australia occurred on 31 May 2004 with the introduction of a number of new mechanisms to protect small use customers in the retail gas market in Western Australia. These mechanisms 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 Authority was given responsibility for the administration of these mechanisms at the time they were introduced.

In addition to the above, a mechanism was also required to provide for churn to allow small use customers to change their gas retailer whenever they wished. 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, and 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 harder 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 administration of the REMCo gas RMS transferred to the Authority on 31 May 2005.

The Act requires a gas RMS to consist of the following elements:

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

3.2 Elements of the REMCo Scheme and how it Operates

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.

3.2.1 *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.

3.2.2 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.

3.2.3 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.

3.2.4 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) which 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.

3.2.5 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.

3.3 REMCo's Rule 17 Review of the REMCo Retail Market Rules

The REMCo Retail Market Rules have been operating in South Australia and Western Australia for more than three years. When the rules were first developed it was agreed that REMCo would conduct a review of its operation after three years to ensure that the operation of these retail gas markets is appropriate. Retail market rule 17 provides for such a review to be undertaken.

It should be noted that the REMCo review only dealt with the Retail Market Rules, which comprise only one part of the REMCo gas RMS, whereas the Authority's review is required to consider the entire scheme.

Rule 17 of the Retail Market Rules states:

Except as otherwise stated in these rules, REMCo must:

- (a) undertake a review of these rules on the third anniversary of the go-live date, or such earlier date as REMCo determines (“review date”); and
- (b) prior to the review date, develop a process to undertake the review (“rules review process”) and notify all persons required to comply with these rules of the rules review process.

3.3.1 Approach Adopted for the Rule 17 Review

On 27 June 2007, REMCo wrote to participants, pipeline operators and prescribed persons providing information on the operation of the Retail Market Rules since their commencement, including detail on market performance, REMCo also sought their views on the operation of the rules.

3.3.2 Submissions Received on the Rule 17 Review

REMCo received a total of six submissions with three submissions coming from Western Australian market participants. These submissions were from Alinta Sales, APA Group and Synergy. The Western Australian Office of Energy also provided a submission.

A brief overview of the Western Australian submissions relevant to the operation of the rules in Western Australia is outlined below.

3.3.2.1 Relevant Issues arising from Submissions to the Rule 17 Review

Alinta Sales (Alinta)

Alinta noted that it was generally satisfied with the operation of the Retail Market Rules. However, Alinta suggested that REMCo should consider providing swing service rule training in Western Australia to promote participant’s knowledge and understanding of this area of the rules.

APA Group (APA)

APA agreed with the view expressed in REMCo’s letter to the effect that the operation of the Retail Market Rules had been generally successful. APA noted that the allocation, reconciliation and swing service rules were established so there was complete equality in the way that balancing is dealt with between the major two interconnected pipelines (Parmelia and DBNGP pipelines) that supply natural gas to Perth. APA believes that the key issue is to find a replacement provider of training to allow market participants to be better informed about the swing service rules rather than to make any change to those rules.

Office of Energy (OOE)

OOE advised that it was satisfied with REMCo’s efficacy over the past three years in operating the gas retail market in Western Australia and did not raise any significant issues.

Synergy

Synergy acknowledged that the existing swing service arrangements had proved very stable and cost-effective compared to other jurisdictions. Synergy advised a preference for a hybrid of contract carriage and market carriage arrangements if there were to be significant changes to the gas balancing arrangements in Western Australia under the Retail Market Rules. Synergy also noted that the co-regulatory model provides a good governance regime for a review of access to contracted gate points in Western Australia.

3.3.3 Outcome of the Rule 17 Review

Following consideration of the submissions received in response to its Rule 17 Review letter, REMCo produced a report on the views of market participants on the operation of the Retail Market Rules for consideration by the REMCo Board. The Board subsequently endorsed this report. On 20 September 2007 REMCo published the report.

REMCo's overall conclusions were that:

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

4 Authority's Review of the REMCo Gas RMS

On 20 August 2007, the Authority published a notice on its web site, together with an Issues Paper. The notice informed the public and interested parties of the review and sought submissions from interested parties over a six week period up to 28 September 2007. At the same time the Authority contacted each of the market participants and provided them with a copy of both the notice and Issues Paper.

4.1 Issues Paper

The Issues Paper was prepared to facilitate submissions from interested parties during the consultation phase of the review. The paper outlined the background to the scheme review and identified the following key issues relating to the operation of the REMCo gas RMS on which the Authority sought comment, as follows:

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

Another issue which was raised in the Issues Paper and on which the Authority sought comment concerned the national gas market reforms and, in particular, the Council of

Australian Governments decision to endorse 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.

4.2 Submissions Received

Five submissions were received on the Issues Paper. These submissions were from Alinta, APA, Dampier Bunbury Pipeline (**DBP**), the OOE and Synergy. These submissions have been placed on the Authority's web site (www.era.wa.gov.au).

All the submissions indicated that the parties were generally happy with the operation of the REMCo gas RMS. Some comments were made in these submissions in regard to particular concerns of market participants.

A brief summary of the submissions is provided below.

Alinta

Alinta stated that the Retail Market Rules have performed to expectations and had no comment about any additional improvement. Alinta also believed that the rule change process had operated well since commencement and that, although there had been no issues that required action in regard to compliance, it was satisfied with the existing arrangements.

Alinta noted that no further changes were required to swing service pricing. However, it suggested that further consideration is required to the hosting of training sessions in Western Australia to promote knowledge and understanding of the rules in this area. Alinta also supported, at a high level, the transfer of REMCo functions to the NEMO from late 2009 acknowledging that this support was dependent on careful consideration and detailed analysis of all potential impacts.

APA

APA advised that, consistent with its submission to the REMCo Rule 17 Review, it had no major concerns with the operation of the REMCo gas RMS to date. However, it reiterated its view that allocation, reconciliation and swing service rules were originally established in order that there be complete equality with the way balancing was to be dealt with between the two major interconnected gas pipelines (Parmelia and DBNGP pipelines) that supply gas to Perth and that swing service volumes and prices in Western Australia have been generally low.

APA indicated that it had no major concern with the potential transfer of REMCo functions to NEMO provided that equal treatment between the Parmelia and DBNGP pipelines in relation to the swing service processes remained so that shippers would not be potentially disadvantaged when using one pipeline or the other. For this reason, APA supports the continuing operation of the current RMS for Western Australia.

DBP

DBP advised that it was generally satisfied with the operation of the scheme and had no specific concerns in relation to the additional issues raised by the Authority in its Issues Paper. However, DBP raised two principal matters of concern. Firstly, the inconsistency in timing of the obligation on DBP to provide daily allocations and accumulated imbalance

notices compared with the time when REMCo is required to provide daily allocations. Secondly, the time it takes to correct daily allocation errors which potentially puts both shippers and pipeline operator in breach of their contractual obligations for the period during which the corrections are made.

DBP advised that both these issues were raised initially during the development of the Retail Market Rules and relate to the allocation of gas delivered from the DBNGP into a distribution system (these issues are discussed further below).

DBP also suggested in its submission that REMCo should be required to provide hourly gas flow data immediately following the relevant hour in a form which can be accessed by pipeline operators and that the Retail Market Rules should be amended to include a provision for daylight saving in Western Australia.

OOE

OOE advised that, in line with its submission to the REMCo Rule 17 Review of the REMCo Retail Market Rules, it was satisfied with REMCo's efficacy in operation of the gas retail market in Western Australia over the past three years. OOE advised that any recommendation to implement a Short Term Trading Market (**STTM**) arrangement in Western Australia would need to be subject to detailed consideration by the Western Australian Government, in consultation with stakeholders. OOE also noted that in respect of the development of a Bulletin Board. The GMLG has recommended that jurisdictions and stakeholders in Western Australia should be consulted further and that consideration of the appropriate use of a Bulletin Board for a jurisdiction's purposes is required.

OOE also advised that the Western Australian Government has not committed to implementing the NEMO in relation to gas or electricity market functions. OOE believed that any transfer of REMCo arrangements to the NEMO is a matter for detailed consideration by Western Australian retail gas market participants. It envisaged that any decision to transfer Western Australian gas retail market responsibilities to the proposed NEMO would only be contemplated if it was deemed that this would result in greater efficiencies for market participants and would deliver benefits to gas consumers.

It also indicated that any decision on this matter would need to take account of the market operator arrangements in the wholesale and retail gas and electricity markets in Western Australia. For instance, should it be decided that electricity full retail contestability is to proceed, consideration would need to be given to options for operation of the electricity retail market, which could involve NEMO or other potential market operators (such as REMCo), the Independent Market Operator or a new Western Australian energy market operator.

Synergy

Synergy agreed with the outcome of the REMCo Rule 17 Review of the Retail Market Rules to the effect that the gas retail market is operating satisfactorily. Synergy supported the view that the swing service arrangements provide a stable and cost-effective supply for retailers. Synergy also highlighted the need for REMCo and the Authority to undertake training and education sessions to promote understanding of swing service arrangements. Synergy reiterated its view that the basis for carriage should be hybrid or contract carriage for foundation shippers and market carriage for retail shippers and acknowledged that this would require a fundamental change to the Retail Market Rules and general market conditions.

Synergy endorsed the creation of the NEMO to reduce regulatory and administrative burdens currently incurred by industry participants on condition that identified key risks and issues are addressed. Given the relative isolation and uniqueness of the Western Australian wholesale electricity and gas markets, Synergy believes it may be preferable to amalgamate separate electricity and gas wholesale and retail market operators over time to create a Western Australian Market Operator (**WAMO**) as a transitional step, with WAMO subsequently being absorbed by NEMO at some later date.

4.3 Issues Arising from Submissions

All the market participants who provided submissions in response to the Issues Paper indicated that they were generally happy with the operation of the REMCo gas RMS.

However, a number of the submissions raised some matters of concern. These matters are discussed below.

ALINTA, SYNERGY, APA

Training on the Swing Service Rules

Issue: Alinta, Synergy and APA have suggested that REMCo should provide training to ensure a better understanding among market participants of the complex swing service rules.

Response: REMCo has advised that it had deliberately not provided training in this area after market start because of the level of costs involved and the potential legal risks associated with such training. However, REMCo advised that one of the companies that supplied services to REMCo M-Co had provided this type of training as a commercial service on its part to market participants. M-Co had since closed its operations in Australia and its role in providing such training had not been filled by other commercial training service providers.

While noting REMCo's advice on this matter, a clear need has been expressed by three market participants for training on the operation of the swing service rules. In these circumstances, it would be expected that REMCo would use its best endeavours to provide such training. If such training is outsourced to a suitable training provider and charged to market participants utilising such training on a commercial basis then REMCo's concerns of legal liability and cost would be addressed.

DBP

Provision of Daily Gas Allocation Information to a Pipeline Operator

Issue: The Retail Market Rules require REMCo to provide daily allocations of actual deliveries of gas to each shipper at a distribution gate point to the pipeline operator by 1230 hours on the following Gas Day. The Pipeline operator is then required to allocate transportation capacity on the pipeline for the relevant Gas Day in accordance with the allocations received from REMCo. However, this obligation is inconsistent with DBP's obligations to shippers to provide allocations and Accumulated Imbalance Notices before 1100 hours. This inconsistency has featured in litigation between DBP and a shipper in regard to the levying of Imbalance Charges. DBP suggests that the Retail Market Rules should be amended to recognise the prior contractual obligations of the parties and that REMCo's systems be modified to permit parties to meet their contractual obligations.

Response: REMCo has advised that this matter was discussed at the time of the development of the Retail Market Rules and it was agreed to use the REMCo allocations in relation to the pipeline contracts to ensure consistency both across delivery points and with respect to the shipper contracts.

DBP has a legislative requirement (section 11ZOD(1)(a) of the Act), once the Retail Market Rules commenced, to comply with these rules. Accordingly, in the absence of any particular provisions in the rules to the contrary, DBP would have been expected to amend shipper contracts, where necessary, to conform with the Retail Market Rules. In any case, DBP has always had the opportunity to take this matter up under the REMCo rule change process through the Balancing Load Allocation Settlement Team (**BLAST**) of which DBP is a member. REMCo has advised that DBP has not raised this matter since the establishment of the Retail Market Rules.

Reconciliation of Errors in Gas Allocations

Issue: When an error in a daily allocation provided by REMCo is identified, that error is corrected over the next 28 days. This leads to inconsistencies between actual daily gas deliveries to shippers and the allocations to those shippers. The result is a difference between the physical imbalances in the pipeline and the contractual imbalances based on allocated gas quantities. This potentially puts both shippers (who have a contractual reasonable endeavours obligation to maintain an accumulated imbalance of zero) and the pipeline operator (who has a reasonable endeavours obligation to maintain a physical pipeline imbalance of zero) at risk of breaching their contractual obligations for the 28 day period during which the corrections are being made. DBP suggests that the Retail Market Rules should be amended to recognise the prior contractual obligations of the parties and that REMCo's systems be modified to permit parties to meet their contractual obligations.

Response: REMCo has advised that the decision to use either a forward reconciliation process or a backward reconciliation process was considered thoroughly when developing the Retail Market Rules and the decision to use a forward reconciliation process was agreed by the two governments (Western Australia and South Australia) primarily because a backward reconciliation process was considered too costly to implement.

Similar to the issue above, DBP has a legislative requirement to comply with the Retail Market Rules and, in the absence of any particular provisions in the rules to the contrary, would have been expected to amend shipper contracts, where necessary, to conform with these rules. As with the previous issue, REMCo has advised that DBP has not raised this matter with the BLAST.

Decisions currently being considered in relation to the introduction of a STTM mean that South Australia is likely to accept whatever reconciliation process is recommended for the STTM. However, in the case of Western Australia, there is uncertainty as to whether the State would participate in the STTM and therefore there is no expectation that the reconciliation process would change within this State at this stage.

Provision of Hourly Gas Flow Data

Issue: DBP has obligations to manage peaking behaviour of shippers to ensure that one shipper's behaviour does not impact on the rights of another shipper. While DBP polls its SCADA system at least each six minutes and can therefore monitor the flow at each outlet point, it is not able to determine which shipper or shippers are flowing gas at a particular time through a multi-shipper outlet point. The Retail Market Rules and agreements between DBP and shippers requires DBP to allocate capacity at outlet points in accordance with the allocation advice received from REMCo. This advice is not received

until 1230 hours on the day following the Gas Day while the management of peaks requires real time monitoring of actual flows for each shipper. DBP suggests that REMCo should be required to provide hourly gas flow data immediately following the relevant hour in a form which can be accessed by pipeline operators.

Response: REMCo has advised that currently the inputs to calculating gas flow data are received up to 3.5 hours after the end of the gas day and it takes a number of hours to produce the gas flow data which is then provided by 1230 hours the next day. For hourly gas flow data to be supplied by REMCo, as suggested by DBP, all providers of data would need to produce hourly numerical data and REMCo would then have to do all of its calculations hourly. This would entail significant additional costs as a result of the need for REMCo to undertake a substantial upgrading of its information technology systems and to employ additional staff to process the necessary data on an hourly basis. It is unlikely that the REMCo members would support such a change in light of the significant costs involved. REMCo has advised that DBP has not raised this matter previously.

Introduce Daylight Saving in Western Australia

Issue: DBP has suggested that the Retail Market Rules should be amended to include provision for daylight saving in Western Australia.

Response: REMCo has advised that it has recently considered this matter and is of the view that there is no need at present for the Retail Market Rules to provide for daylight saving in Western Australia as there are no gas contracts in place in that State which contain times denoted in terms of daylight saving time. Gas contracts in South Australia make use of daylight saving times as daylight saving has been in place in that State for many years and the rules in South Australia allow for this. This matter is being monitored by REMCo and is likely to be revisited when the outcome of the referendum on daylight saving in Western Australia to be held at the completion of the current daylight saving trial period is known.

ALINTA, SYNERGY, APA

Future National Reforms and their Impact on the Operation of REMCo

Issue: Alinta, APA and Synergy each provided qualified support to the future potential transfer of REMCo functions to NEMO.

Alinta's support was conditional on careful consideration and detailed analysis of all potential impacts. APA's support was on condition that such a process would not undermine equal treatment of the Parmelia and DBNGP pipelines in relation to swing service processes so that shippers would not be potentially disadvantaged when using one pipeline or the other. Synergy's support was conditional upon addressing identified key risks and issues and suggested that a staged process occur over time, with a transitional step being the formation of a WAMO.

Response: The comments provided in submissions on the issue of a potential future transfer of REMCo's functions to NEMO and general qualified support for such a move expressed by market participants in the submissions is noted.

The Authority believes it is important to ensure that the comments of market participants in their submissions regarding the potential future transfer of REMCo's functions to the NEMO are provided to the OOE for its consideration, in order to assist this agency in formulating appropriate advice to the Western Australian Government. For this reason, the Authority will write to the OOE conveying the views expressed by a number of market

participants in relation to a potential future transfer of REMCo's functions into the proposed NEMO.

It should be noted that the NEMO has recently been renamed the Australian Energy Market Operator or (**AEMO**).

5 Conclusions and Recommendations

5.1 Conclusions

All the submissions received by the Authority indicated general support for the manner in which the REMCo gas RMS is currently operating. This was consistent with the result of REMCo's Rule 17 review of the operation of the Retail Market Rules which found that the gas retail markets in South Australia and Western Australia were largely operating to the satisfaction of participants involved.

The Authority concludes that the REMCo gas RMS is currently operating satisfactorily and that no changes to the provisions of the scheme to achieve the purposes set out in section 11ZOB of the Act appear to be warranted.

5.2 Recommendations

Based on the discussion outlined under Section 4.3 in this report, the Authority considers that REMCo should address the training needs expressed by market participants in relation to the swing service rules in the interests of ensuring that the REMCo gas RMS meets the requirements outlined under section 11ZOB of the Act.

The Authority recommends that REMCo should address the training needs expressed by a number of market participants in relation to the swing service rules, by arranging for a suitable training provider to provide the required training on appropriate commercial terms.