

17 February 2011

Prohibition and Restriction on Synergy and Verve Energy
Economic Regulation Authority WA
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Dear Mr Rowe ,

Prohibition and restriction on Synergy and Verve Energy under the *Electricity Corporations Act 2005* (Issues Paper)

ERM welcomes the opportunity to comment on the Economic Regulation Authority's (ERA) Issues Paper on Prohibition and restriction on Synergy and Verve Energy under the *Electricity Corporations Act 2005* (Issues Paper).

ERM develops, owns and operates generation facilities in both the National Electricity Market (NEM) and the Wholesale Electricity Market (WEM). ERM has lead development of both the Neerabup Power Station and Kwinana Power Station and currently operates both generation facilities.

In 2010 ERM successfully gained an electricity retailing licence to sell electricity in the South West Interconnected System (SWIS)

ERM's entry into the Western Australian energy market is a direct result of the electricity reform process and the controls put in place to restrict the market power of Verve energy and Synergy.

The Economic regulation Authority has invited comment on:

1. The effectiveness of the generation Prohibition placed on Synergy and the retailing Restriction placed on Verve Energy in enhancing competition in the generation, retail and wholesale markets;

ERM comment

- General comments

- Out of the electricity reform process, the ERTF put forward a set of recommendations that would assist in achieving improvements and efficiencies in the electricity industry in Western Australia.
- One of the key ERTF reforms was to increase competition. The ERTF recommended the monopoly power held by Western Power needed to be reduced by vertically disaggregating the organisation into generation, electricity retail, and transmission and distribution, allowing new entrants into the generation and retail space.
- Once disaggregation of Western Power occurred a set of measures were put in place to control the transitional market power of the generation company (Verve Energy) and the retail company (Synergy). A generation Prohibition was placed on Synergy and a retail Restriction placed on Verve Energy.

- In addition to these restrictions in the Electricity Corporation Act 2005, there were also additional Ministerial Direction that limited Verve Energy to a 3,000MW generation capacity cap, and Synergy could not form a virtual vertically integrated company. These Ministerial Directions were put in place to ensure that new companies formed from the vertical disaggregation of Western Power could not reintegrate vertically which would result in the companies wielding too much market power in the transitional market.
- Full retail contestability (FRC) is a key objective of market reform.
- The Wholesale Electricity Market System (WEMS) is still in a transitional phase and is currently being reviewed via the Market Evolution Program (MEP), which will implement some important changes to the way that the WEMS operates.
- The market will be in a transitional phase until the reform objectives are achieved.
- **Retail Market**
 - New Entrant retailers have entered the market which has been assisted by the restrictions on Verve Energy and Synergy, but there are competitive barriers.
 - Synergy is still able to exercise a large amount of market power for the following reasons:
 - Large market share
 - Large bilateral energy contracts with new entrants that are significantly cheaper than the current cost of building new generation; new entrant retailers are not able to access wholesale electricity at competitive prices.
 - Long term bilaterally traded capacity credits that are well below the current cost of capacity; new entrant retailers are not able to buy capacity credits at competitive prices.
 - Long term bilateral energy contracts struck when gas prices were \$2-3/GJ making their cost of energy cheaper than new entrant retailers.
- **Generation Market**
 - New entrant generators have entered the market on the back of long term bilateral contracts. This has resulted from the combined effect of the 3,000MW generation capacity cap placed on Verve Energy and the Synergy generation prohibition in the electricity Corporations Act 2005.
 - The restrictions on Verve Energy and Synergy in the Electricity Corporations Act 2005 has encouraged New Entrant Generators and has therefore been effective in attracting new entrant generators.
- **Wholesale Electricity Markets**
 - Due to the increased competition (for the reasons set out above), particularly on the sales side, there has been an increase in inter-competitor trading and therefore an increase in price transparency although given it's a net market transparency is still low.
 - For so long as competition continues to be promoted and new retailers enter the market, the inter-competitor trading and therefore price transparency will be further enhanced.

2. The impact of terminating the generation Prohibition placed on Synergy and the retailing Restriction placed on Verve Energy in 2013 or extending these until 2016.

ERM Comment

- We believe that it is necessary to extend prohibition and restriction on Synergy and Verve Energy under the Electricity Corporations Act 2005 for the following reasons:
 - The market power of Verve Energy and Synergy will increase and thus have a negative effect on competition leading to increased barriers to entry for new entrant generators and retailers. Existing generators and retailers will also find it increasingly difficult to compete if Verve energy and Synergy exercise their market power.

- The market is still in a transitional phase, FRC has not been achieved and the (revised) Vesting Contract 2010 is still in place.
- A significant section of the contestable market remains locked into Synergy, as they are still on non cost-reflective tariffs, and remain subsidised by taxpayers. Making customers on L3, R3, S1 and T1 tariffs exposed to the contestable market should also be a priority to ensure competitive market benefits in the WEM.
- The Market Evolution Program (MEP) is underway and these changes should be embedded before restrictions are lifted on Verve Energy and Synergy.
- If Verve Energy can supply large loads directly, they will be motivated not to sell bilateral electricity and capacity at competitive rates to existing and new entrant retailers. Verve will have the power to effectively shut down the contestability in the retail market.
- Synergy has retained 80% of the electricity retail market share in the SWIS in recent years and Verve Energy has still retained a large market share reducing from 77% to 61% since 2007. There is a real danger of a dominant duopoly occurring if the restrictions and prohibitions are lifted in 2013. The current restrictions and prohibitions have not yet succeeded in opening up the contestable market to the full forces of competition.

If you would like any further information in relation to this submission please contact Stephen St Baker at [sssbaker@ermpower.com.au](mailto:sstbaker@ermpower.com.au) or (07) 3020 5100.

Yours sincerely,



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