



REMCo believes that competitive markets are the most appropriate way to set prices. As a result, the goal for this inquiry should not be to find ways to reduce gas prices in Western Australia, as prices that are too low would lead to gas supply shortages. Instead, the inquiry should investigate how to ensure that gas prices are set by a properly functioning competitive market.

Since REMCo is the gas retail market operator for Western Australia, REMCo's comments are restricted to retail market concerns, and comments on upstream matters are left to other parties.

However, REMCo notes the strong linkages between the gas and electricity sectors, and that improving the competitiveness of the Western Australian energy retail market (gas and electricity) will allow for more efficient, market-driven gas prices.

The economic literature extensively covers what is needed for markets to be competitive, so REMCo will not attempt to summarise this subject matter. Instead, REMCo provides some specific recommendations in the attached paper on steps that the Western Australian Government can take to promote competitive energy retail markets in the State.

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Yours sincerely,

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Attachment: REMCo Submission to the Parliamentary Inquiry – Domestic Gas Prices



REMCo Submission to the Parliamentary Inquiry – Domestic Gas Prices

REMCo Members support the following principles as a means to support competitive gas and electricity markets:

- gas and electricity retail tariffs should be made cost-reflective as soon as possible;
- authority for setting gas and electricity retail tariffs should be provided to an independent authority, based on a clearly established and transparent tariff setting mechanism; and
- policies to enable further competition in retail energy and upstream fuel markets should be pursued as soon as possible.

REMCo makes the following five recommendations on steps that the Western Australian Government can take to promote competitive energy retail markets in the State

1. Retail Tariffs

The primary issue impeding competition in the retail energy markets is that gas and electricity retail tariffs are not cost-reflective.

It is critical for Government to make gas and electricity tariffs cost-reflective as soon as possible, as the beneficial impacts of any other energy market reforms will be significantly muted until the retail tariffs are corrected.

1.1. Gas Retail Tariffs

The Office of Energy completed a review of the *Energy Coordination (Gas Tariffs) Regulations 2000* (the “Gas Tariff Regulations”) in October 2007, and two subsequent reviews of the level of gas retail tariffs imposed by the Gas Tariff Regulations.

Government has increased the gas retail tariffs in response to these interim reviews, but has not made clear policy decisions on gas tariff regulation.

REMCo recommends that the Office of Energy should conduct a full review of gas retail tariffs, similar to the Electricity Retail Tariff Review (see section 1.2), as it is not appropriate to have continued annual interim gas retail tariff increases.

The Gas Retail Tariff Review should consider a number of recommendations similar to those under the Electricity Retail Tariff Review, including:

1. gas retail tariffs should be made cost-reflective as quickly as possible;
2. consideration should be given to adjusting the gas retail tariff structure to make the tariffs more efficient;
3. all gas rebates to residential customers should be increased in proportion to any Government-approved gas retail tariff increases;
4. social policy objectives (i.e. addressing the impact of gas retail tariff increases on low-income households) should be addressed via direct Community Service Obligation payments rather than through cross-subsidies;
5. gas retail tariffs should be set by an independent agency, such as the Economic Regulation Authority; and



6. gas network tariffs and costs from environmental policies (such as the Carbon Pollution Reduction Scheme and Renewable Energy Target) should be automatically passed through the gas retail tariffs, and should be separately itemised on retail bills.

The Western Australian Government can greatly increase the prospects for competition in the gas retail market by undertaking a Gas Retail Tariff Review and by implementing the recommendations such as those outlined above.

1.2. Electricity Retail Tariffs

On 29 January 2009, Government released the Office of Energy's Final Report from the Electricity Retail Tariff Review. The Office of Energy made nine recommendations, including:

1. the level of cost-reflective electricity tariffs for small-use (residential and small business) customers and timing to make the tariffs cost-reflective;¹
2. the structure of electricity tariffs for small-use customers;²
3. all electricity rebates to residential consumers should be increased in proportion to any Government approved electricity retail tariff increases;
4. the specialised electricity retail tariffs for community and charitable organisations should be replaced by direct Community Service Obligation payments;
5. the level of cost-reflective electricity retail tariffs for large customers, with the tariffs to be made cost-reflective immediately;
6. Government's uniform tariff policy in Horizon Power's supply areas should be funded by a direct Community Service Obligation payments rather than the Tariff Equalisation Fund;
7. electricity retail tariffs should be set by an independent agency, such as the Economic Regulation Authority;
8. electricity network tariffs should be automatically passed through in all electricity retail tariffs and should be separately itemised on retail bills; and
9. costs from environmental policies should be automatically passed through electricity retail tariffs and separately itemised on retail bills.

While the Western Australian Government has increased all electricity retail tariffs in 2009 and 2010, it has not made a decision on any of the nine recommendations from the Electricity Tariff Review.

REMCo believes that the Office of Energy's recommendations are appropriate (noting that the retail tariff forecasts are old and need to be updated), and that Government should to make a decision on all nine recommendations, including specifying the timing and process for implementation of the recommendations).

¹ It was recommended that Government select a "glide path" to make small-use customer tariffs cost-reflective over time, and that the difference between the glide path and the cost-reflective rates should be funded via Community Service Obligation payments.

² The recommendation dealt with how to handle the Carbon Pollution Reduction Scheme costs and network tariffs within the retail tariffs; and considerations for moving to other tariff structures in the future, such as inclining block tariffs and/or time-of-use tariffs.



1.3. Energy Vs. Social Policy

Government needs to separate its social policy objectives from its energy policy objectives. This is not to say that either policy is more or less important than the other, only that policies measures should be designed to directly target the policies they are intended to address:

- From an energy policy perspective:
Gas and electricity tariffs need to be made cost-reflective for all consumers, and the full costs of environmental policies need to be passed on to all consumers, so that the tariffs can send the appropriate price signals to consumers to adjust their behaviour.
- From a social policy perspective:
Implementing cost-reflective gas and electricity tariffs and environmental policies will inevitably have undesirable impacts on low-income households; and Government will rightfully want to protect the interests of such persons.

However, this does not suggest that tariffs should be held below cost-reflective levels; as such a policy would destroy competition, and distort consumer behaviour by altering the price for all consumers, not just those that need social protection. Instead, Government should provide a direct subsidy to such households to offset the financial impact of its energy policies.

1.4. Tariff Regulation Reform

Legislation and regulations should be developed to give an independent agency, such as the Economic Regulation Authority, the power to set gas retail tariffs. The legislation/regulation should:

- specify the Government policies that must be addressed in setting the retail tariffs (e.g. uniform tariffs, pass-through of network tariffs and costs from environmental policies, etc.);
- indicate the objectives for setting the tariffs (e.g. allowing a commercial return to retailers, sending the appropriate price signal to consumers, etc.);
- indicate the calculation methodology, data sources, and consultation process that the independent agency is to use in setting the retail tariffs; and
- set the timelines for the regular retail tariff re-set process.

As indicated in section 1.3, any social policy objectives (such as rebates to low-income households, standard form contracts, access to an energy ombudsman, etc.) should be addressed outside of the tariffs.

1.5. The Ongoing Need for Tariffs

An independent review of the continued need for gas and electricity retail tariff regulation in Western Australia should be undertaken once:

- the gas and electricity retail tariffs are made cost-reflective and are independently set by the Economic Regulation Authority; and
- practical electricity full retail contestability ("FRC") has been put in place (see section 3).



The Australian Energy Market Commission has undertaken such reviews for Victoria and South Australia, and the Economic Regulation Authority could conduct a similar review for Western Australia (leaving the decision on this matter with Government).

2. The Gas Market Moratorium

An impediment to competition in the downstream gas market is the Gas Market Moratorium that restricts Synergy from competing for gas customers that consume less than 0.18TJ/a.

As the Gas Market Moratorium is intended to ensure competitive neutrality (it restricts Synergy from competing in the gas retail market until other retailers are able to compete in the electricity retail market), it should be removed as soon as practical electricity FRC is implemented (see section 3).

3. Electricity Full Retail Contestability

The lack of electricity FRC is another significant restriction on competition in the downstream energy markets.

The legal restriction on retailers from competing for small-use electricity customers (those that consume less than 50MWh/a) is a clear impediment to electricity market competition; but since most retailers would be interested in making dual-fuel offers to customers, the lack of electricity FRC is also an impediment to gas market competition.

The Western Australian Government should consider implementing electricity FRC as a means to increase competition in both the gas and electricity markets.

Timing for implementing electricity FRC is an issue, as the costs associated with implementing electricity FRC should be avoided until there is a reasonable prospect for competition.

In REMCo's view, the two primary barriers to electricity FRC are that electricity retail tariffs are currently set below cost (see section 1), and liquidity concerns in the wholesale electricity market.

The Minister of Energy initiated a review in 2009 of the financial outlook for Verve Energy, its ability to support the reliability of electricity generation in the State, and the outlook for the State's investment in the utility (commonly referred to as the "Oates Review"). The Oates Review recommended a number of changes to the Wholesale Electricity Market that are intended to improve efficiency of the market.

REMCo believes that it would be appropriate to target electricity FRC for the same time that electricity retail tariffs are made cost-reflective. This is because market development may be too slow if the Western Australian Government waits to implement FRC until after the Wholesale Electricity Market liquidity issues are fully resolved. Implementing electricity FRC would increase pressure to resolve the liquidity issues.

4. Energy Market Integration

One way to improve gas and electricity market competition is to integrate the gas and electricity markets.



There are currently two Market Operators in Western Australia – REMCo (who operates the Gas Retail Market), and the Independent Market Operator (who operates the Wholesale Electricity Market).

REMCo believes that consideration should be given to integrating market operations into a single entity.

However, some important energy market developments are currently being pursued, such as addressing the liquidity issues in the Wholesale Electricity Market (see section 3), and establishing a Gas Bulletin Board and a Gas Statement of Opportunities.³

Once these current energy market developments have been addressed, Government should undertake a public consultation process to determine whether to integrate market operations, and if so, the appropriate governance structure for the consolidated entity.

³ Following the gas supply disruption caused by the Varanus Island gas explosion, the Western Australian Government established the Gas Supply and Emergency Management Committee ("GSEMC") to review and provide advice to Government on the State's gas security, gas supply disruption management, and mitigation options for gas supply disruptions. Government has accepted the GSEMC recommendations, which amongst other things, included establishing two new gas market mechanisms:

- Gas Bulletin Board:
The Gas Bulletin Board will be web-based "gas system and market" information mechanism that provides up-to-date information on gas production, transmission pipeline, and gas storage capacity; and on daily demand. The Gas Bulletin Board will be available to the gas industry and the public to help them reach an informed view of physical gas flows, market opportunities, risk mitigation options, and new investment opportunities. The Gas Bulletin Board will also allow gas market participants to voluntarily publish bids to buy or offers to sell gas and transportation capacity.
- Gas Statement of Opportunities:
The Gas Statement of Opportunities will be a 10-year outlook of demand, supply, and storage and network capacity. The Gas Statement of Opportunities will highlight where potential supply shortfalls or transportation constraints might occur in the future, and will be developed and published in ongoing consultation with industry stakeholders. The Gas Statement of Opportunities will assist industry, Government, and new investors in making commercial decisions about investment in infrastructure or commencing commercial negotiations with other parties in the gas industry.

The Western Australian Government is currently in the process of deciding who should develop and operate these gas market mechanisms, and REMCo has made a submission to Government asking to be appointed to this role. Once the Gas Bulletin Board and Gas Statement of Opportunities have been established, further development can be considered to facilitate the competitive trade of gas and gas transmission capacity, such as by establishing a Short Term Trading Market.