



Gas Markets Moratorium: Issues Paper

April 2006

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Overview

In September 2002, the Government of Western Australia and Alinta (then AlintaGas) entered into a Gas Market Agreement.

Central to the agreement was the amendment to a moratorium that prevented Western Power from supplying gas to customers within AlintaGas's trading licence areas. The change prohibited the entry of Western Power into the market to provide gas to customers using less than one terajoule per annum until there was full retail competition in the electricity market.

The Gas Market Agreement also allowed provision for the State Government to change the moratorium with effect from 1 July 2007, regardless of whether or not electricity full retail contestability had been achieved.

Given the long lead times necessary for suppliers to enter small use energy markets, the Government considers that as much notice as possible should be given of any changes to the moratorium and is therefore undertaking a review of the moratorium in the first half of 2006.

The Office of Energy has been requested by the Minister for Energy to:

Review and make recommendations as to whether the moratorium on the former Western Power Corporation should be changed to permit its successor entities (Synergy and Verve Energy) to sell gas to more or all customers in the Western Australian gas market, having regard to delivering sustainable competition in the gas and electricity markets.

As part of this review, the Office of Energy is seeking submissions from all interested parties on whether changes are required to the current moratorium and, if so, how the moratorium should be amended.

This Gas Markets Moratorium Issues Paper has been prepared to assist all interested parties with framing their submissions.

Submissions are invited by close of business on Friday 5 May 2006 and should be addressed to:

Moratorium Review
Office of Energy
Level 9, Governor Stirling Tower
197 St Georges Terrace
PERTH WA 6000

or by email to: moratorium@energy.wa.gov.au

The Office of Energy will be posting submissions received on the Office of Energy website at www.energy.wa.gov.au. If any aspects of the submission are considered confidential, the areas should be clearly identified and the reasons for a claim of confidentiality noted in a covering letter.

Any enquiries on any aspects of the review should be directed to:

Jason Banks
Acting Director Markets and Regulatory Policy
Office of Energy
Level 9, Governor Stirling Tower
197 St Georges Terrace
PERTH WA 6000

Tel (08) 9420 5687 or email: moratorium@energy.wa.gov.au

Background to the Moratorium

A moratorium was imposed on Western Power in October 2000 (“the original moratorium”) as part of the disaggregation of the then State Energy Commission of Western Australia into Western Power and AlintaGas and subsequent privatisation of AlintaGas.

The original moratorium prevented Western Power from selling gas for a period of three years to customers within AlintaGas’s trading licence areas. It was based on a need to encourage development of a competitive gas market in Western Australia.

Several issues concerning development of the gas market emerged as the end of the original moratorium period approached. The two most significant issues were:

- which agency would bear the costs of developing full retail contestability in gas; and
- an ability by Western Power to sell gas to all customers in the gas market while AlintaGas, as an electricity supplier, would be precluded from selling electricity to customers taking less than 300 Megawatt hours per year.

In response to these issues, the Government entered into a Gas Market Agreement with AlintaGas in 2002. The details of this agreement are discussed below. The agreement included a direction to Western Power by the State Government that imposed a moratorium on it supplying gas to customers taking less than one terajoule per annum.¹

As the moratorium was applied to Western Power as an integrated organisation, it was necessary to ensure that disaggregation did not allow it to lapse. Accordingly, the *Electricity Corporation Act 2005* extended the moratorium to the successor entities Synergy (formerly Western Power’s retail business) and Verve Energy (formerly Western Power’s generation business) from their establishment on 1 April 2006.

Key Features of the Gas Market Agreement

The key features of the Gas Market Agreement were:

- The moratorium itself, preventing Western Power from competing in the less than one terajoule market.
- Funding by the State Government to develop the market rules for gas full retail contestability.
- Funding by AlintaGas of the Retail Market Operator and provision of a financial guarantee capped at \$10 million to enable the Retail Market Operator to start operation.
- Retail tariff caps for both residential and non residential small use customers. Tariffs to be escalated at the consumer price index with the exception of the third step of the residential tariff cap in the South West Area.
- AlintaGas to complete development of network information systems necessary for full retail contestability within 12 months of the Regulator approving cost recovery from network access users.

For background information, the Government of Western Australia’s media release is attached to this Gas Markets Moratorium Issues Paper.

¹ *Western Power Corporation (Gas Supply) Amendment Direction 2002*, 18 October 2002.

Changes to the Moratorium

The original moratorium had a three year period and would have automatically lapsed in October 2003. While the Gas Market Agreement does not have any similar provision for the moratorium to lapse following a certain time period:

- it would automatically be lifted following the introduction of full retail contestability in electricity; and
- the State Government may change the moratorium from July 2007.

The Office of Energy is currently reviewing the moratorium and proposes that any changes that may result from the review would take effect from July 2007.

Issues for review

The Office of Energy has identified a range of issues which it considers are relevant to the review and invites comment on these issues. Submissions on any other relevant issues would be welcomed.

The Moratorium and the Western Australian Gas Market

Full retail contestability in gas was completed on 31 May 2004 when the Retail Market Scheme started. There are now no legal or regulatory barriers to competition in the small use gas market. To date, no significant competitor has emerged at the small use level (residential and small business customers), with competition restricted to higher volume users.

Maximising competition for all customers in the Western Australian gas market is a key State Government objective that will be considered as part of the moratorium review.

There appear to be a number of barriers to suppliers entering the small use gas market including:

- relatively low levels of domestic gas consumption compared to other jurisdictions; and
- high initial fixed costs in areas such as billing and marketing, creating a significant commercial advantage for Alinta as the incumbent retailer.

Lifting the moratorium may result in increased competition for small use gas customers through access to the market by Synergy or Verve Energy.

The Office of Energy invites comments on barriers to entry in the Western Australian gas market, the identification of any impact of the moratorium to date on competition in the State's energy market and recommendations on how it might be changed to promote competition.

Issues:

- *What are the barriers to entry facing additional gas retailers in Western Australia?*
- *How has the moratorium impacted on gas retail competition?*
- *Should the moratorium be amended to increase gas retail competition, if so, how?*
- *Are there any other costs or benefits relating to the gas market arising from the moratorium?*

The Moratorium and the Western Australian Electricity Market

The revised moratorium was based around the proposition that Western Power should not be allowed full access to the gas market while AlintaGas was denied full access to the electricity market.

A number of considerations were advanced at the time to support this proposition:

- While gas and electricity involve different infrastructure, there are a number of common activities such as billing and marketing, enabling a dual fuel supplier to implement “economies of scope”.
- A retailer who offers both gas and electricity may have the ability to recover common costs from both markets, effectively allowing it to earn higher than regulated returns. That is, common costs of being a retail supplier such as customer service costs, billing, bad debts and so on may be recovered from both markets. If regulation to prevent companies earning excessive returns is based on allowing a company to recover the efficient costs of operating in a single market, it may not recognise the “economies of scope” of dual fuel supply, in effect allowing a regulated company to over-recover on its costs.
- Customers have a preference for dual fuel provision as it allows them to deal with a single utility, have a single bill, joint metering and the possibility of lower prices. Allowing only one retailer the ability to meet this customer preference confers a significant competitive advantage.
- The combination of being the only company able to supply both gas and electricity for small users and the cost advantages of doing so may be sufficient to prevent the emergence of another dual fuel supplier to compete against the incumbent.
- Allowing Western Power to compete against AlintaGas in the gas market while AlintaGas could not do the same in the electricity market would violate the principles of competitive neutrality in that two firms in the same circumstances are being treated differently.

Comments are invited on allowing Synergy or Verve Energy full access to the gas market prior to the introduction of electricity full retail contestability, and other options and impacts that need to be considered in the current circumstances of the reform of the electricity market in Western Australia.

The Office of Energy invites comments on the extent to which lifting the moratorium would result in improved services and prices for consumers.

Issues:

- *Are the discussion points noted above against allowing Synergy or Verve Energy full access to the gas market ahead of electricity full retail contestability valid?*
- *Are there any other discussion points against allowing Synergy or Verve Energy full access to the gas market ahead of electricity full retail contestability?*
- *To what extent would the effects predicted by these arguments be likely to occur in Western Australia if the moratorium were to be lifted?*
- *Would lifting the moratorium, allowing Synergy to develop dual fuel supply, result in improved services and prices for consumers?*
- *What impact would lifting the moratorium have on competition in retail energy markets in the long-term?*

Equivalent Contestability Levels in Gas and Electricity

The Gas Market Agreement provided that the moratorium should automatically be lifted once full retail contestability in electricity occurred.

Timing of electricity full retail contestability is uncertain, however, it is likely to be deferred until after the key elements of electricity reform have been completed. The *Electricity Corporations Act 2005* provides that a review of the introduction of further retail competition must be conducted as soon as practical following April 2009.

The purpose of the review is to consider whether or not further competition, including full retail competition, is to be introduced in areas of the State where Western Power (formerly Western Power's electricity networks business) and Horizon Power (formerly Western Power's regional business) operate electricity distribution systems.

At the time the moratorium was introduced, electricity contestability levels were set at total annual consumption of 300 Megawatt hours which is equivalent to an annual average load of 34 kilowatt hours which in turn was roughly equal in energy consumption terms to one terajoule of gas per year. The moratorium therefore imposed a similar market entry barrier on both AlintaGas and Western Power as expressed in energy consumption terms.

Since then, electricity contestability levels have fallen to 50 Megawatt hours or an annual average load of 5.7 kilowatt hours. This is roughly equivalent to annual consumption of 180 gigajoules of gas per year.

However, there was no provision in the Gas Market Agreement for the moratorium to be varied according to subsequent changes in electricity contestability, other than full retail contestability, and the moratorium has therefore been retained at the one terajoule level.

Based on energy consumption, Alinta is currently able to compete for a greater range of customers in electricity than Synergy or Verve Energy can in gas. As noted above in the

discussion of the moratorium and the electricity market, a number of arguments have been advanced as to why disparate market access might be undesirable in the context of allowing Synergy or Verve Energy full access to the gas market.

The Office of Energy invites comments as to whether these issues also apply to Alinta's greater access to the electricity market, both now and in the future.

The Office of Energy invites comment on whether the moratorium should be amended to put Alinta and Synergy or Verve Energy on an equivalent basis in the electricity and gas markets respectively.

Energy consumption levels, however, are only one measure. Other possible measures are percentage of customers (different market structures mean that a given energy consumption in gas represents a different market share to electricity) and amount of sales revenue that is contestable. There may also be other measures.

If amending the moratorium to deliver equivalent access to the market is seen as a desirable outcome, the Office of Energy invites comment on how equivalent access should be defined and at what level it should be set.

Issues:

- *To what extent do the arguments against allowing Synergy or Verve Energy full access to the gas market prior to electricity full retail contestability apply to Alinta's current access to the electricity market?*
- *What effects have there been from this greater access by Alinta?*
- *Should the moratorium be amended so that Alinta and Synergy or Verve Energy have equivalent access to the electricity and gas markets respectively?*
- *If so, should this equivalent access be expressed in energy consumption, market share, revenue exposed to competition or some other measure?*
- *At what level should any equivalent access measure be set?*

Subsequent Changes to the Moratorium

As noted above, the moratorium currently provides for automatic lifting of the moratorium in the event of full retail electricity contestability and an ability for the State Government to change the moratorium after July 2007.

The Office of Energy invites comment on whether it should be subject to review at a later date or whether it should automatically be lifted based on timing or the occurrence of particular events, should the moratorium continue in some form post 2007.

Issues:

- *If the moratorium continues post July 2007, should it provide for automatic lifting or changes if defined events occur?*
- *If so, what events should be included and what should be the changes?*
- *Should a post July 2007 moratorium include provision for review, amendment or abolition based on a defined timetable?*
- *If so, what timing should apply and what changes should occur?*

Application of the Moratorium to Synergy and Verve Energy

As noted above, the Electricity Corporations Act automatically extended the moratorium to Synergy and Verve Energy in April 2006. References to application of the moratorium in this paper have therefore been to both organisations as it will apply equally to both. The moratorium will not apply to Horizon Energy which undertakes its energy supply functions outside of the South West Interconnected System.

However, given the different roles to be played by Synergy and Verve Energy in the Western Australian energy market, it may be appropriate to consider whether the moratorium should apply to both organisations.

Synergy performs the former retail business functions of Western Power within the South West Interconnected System. It retails electricity to customers that were formerly supplied by Western Power. It also sells gas to customers formerly supplied by Western Power. Synergy therefore has an existing franchise and contestable electricity customer base, retail infrastructure and portfolio of gas customers in the above one terajoule category. As a result, in the absence of the moratorium, Synergy may have the ability to sell gas to small users and offer a dual fuel package.

Verve Energy is the former generation business of Western Power. Its functions under the Electricity Corporations Act include the generation, purchase and supply of electricity and the transport and supply of gas within the South West Interconnected System. However, the Act also provides for a period of at least seven years that Verve Energy is not able to supply electricity for a "person's own consumption" unless expressly authorised by the Minister for Energy. Verve Energy will not therefore be able to retail electricity for at least this transitional period.

This restriction was applied to prevent the possibility of generation immediately acquiring a retail capacity and hence effectively re-integrating in the South West Interconnected System electricity market.

While Verve Energy is prevented by the Electricity Corporations Act from retailing electricity, the Act does not prevent it from retailing gas. However, as the moratorium currently applies to Verve Energy, it is effectively precluded from selling gas to small users.

If the moratorium did not to apply to Verve Energy, it would be free to sell gas to small users. However, as it cannot retail electricity, Verve Energy does not have nor can it develop retail

infrastructure such as billing systems and an electricity customer base. These factors may hinder its ability to sell gas to small users. Nor can it provide dual fuel to small customers as it cannot retail electricity.

The Office of Energy invites comment on whether the moratorium should be applied to both Synergy or Verve Energy.

Issues:

- *If the moratorium continues beyond July 2007, should it be applied to both Synergy and Verve Energy?*
- *Do the arguments advanced for a moratorium on Western Power apply equally to both successor entities?*
- *What would the impact be on small use customers if Verve Energy was permitted to sell gas in the sub one terajoule market?*
- *Would allowing Verve Energy to develop a gas retail capacity be counter to the intent of preventing it from retailing electricity in the short-term?*

Other Issues

The Office of Energy invites comment on whether there are any other issues that need to be considered in the review of the moratorium, in particular any costs and benefits that have not been canvassed above.

Issue:

- *Are there any other costs and benefits arising from the moratorium that need to be considered in the review?*

Attachment 1: Moratorium Press Release

Government of Western Australia
Media Statement

Government brings cheaper gas to consumers and small business and encourages competition

11/09/02

A State Government agreement with AlintaGas, released today, will hold down the price of gas to Western Australian households and facilitate practical competition in the gas market.

Energy Minister Eric Ripper said under the agreement household gas price increases would be capped at the Consumer Price Index (CPI).

The last Coalition government put in place a system where prices could be raised by CPI plus two per cent.

The new pricing system will apply from July 1 next year.

Mr Ripper said also the tariff cap for small business would be reintroduced. Under arrangements put in place by the Coalition government, the cap was abolished on July 1 this year.

"These changes will see cumulatively lower residential tariff caps in the future than would have applied and that the interests of the small business sector are also being protected," he said.

The AlintaGas agreement paves the way for expanded competition to give residential and small business consumers a choice in gas supplier.

Central to the agreement is the amendment to a moratorium that currently prohibits Western Power from entering the residential gas market.

The change will prohibit the entry of Western Power into the market to provide gas to customers using less than one terajoule per annum until there is full retail competition in the electricity market.

However, Western Power can enter the market from October next year for customers using more than one terajoule per annum.

During 2006, the proposed Economic Regulation Authority may review the Western Power moratorium on entering the small gas user market.

Mr Ripper said the State Government had also reserved its right to end the moratorium from July 2007.

"We believe that these moratorium changes will encourage new gas suppliers to enter our residential and small business gas market," he said.

Gas suppliers involved in the current gas deregulation process include Origin, AGL, CMS Energy and Wesfarmers.

"The changes will also ensure competitive neutrality by preventing a situation where only one retailer has the opportunity to provide both gas and electricity to the small-use customer end

of the market.

"With a competitive gas retail market, consumers will be able to choose the gas supplier that best suits their needs. Competition is likely to put downward pressure on prices, maximise efficiency and improve service delivery."

Under the agreement AlintaGas will fund the establishment of the Retail Market Operator for the gas market.

It will also provide a financial guarantee (capped at \$10million) to the extent necessary to enable the Retail Market Operator to contract for the Retail Market Information System that will enable and support full gas competition.

"The agreement with AlintaGas not only provides potential benefits to gas customers in the short term, but achieves greater certainty regarding the introduction of retail competition in the gas market," Mr Ripper said.

Key aspects of the agreement reached with AlintaGas are attached.

Minister's office: 9222 8788

Arrangements to Introduce Full Retail Contestability into WA Gas and Electricity Markets

Key Points:

1. The Government will fund the development of the market rules for gas full retail contestability (FRC) that form the basis of the functional specification for the tender of the Retail Market Information System, and not seek to recover this funding from participants in the gas market.

2. AlintaGas will fund the establishment of the Retail Market Operator, and will provide a financial guarantee (capped at \$10million and to be phased out once the Retail Market Operator is operating effectively and is financially sound) to the extent necessary to enable the Retail Market Operator to:

- fund the development of a load profiling arrangement and functional specification for the Retail Market Information System that reflects the market rules;
- enter into a contract for the provision of the Retail Market Information System to the Retail Market Operator; and
- commence business.

3. The gas retail tariff cap (for all three licence areas - Coastal, Kalgoorlie and Albany) will be revised and based on AlintaGas' tariffs as at July 1, 2002 and will be escalated annually from July 1, 2003 at CPI. Tariff caps will apply to residential and non-residential small-use customers. However, the third step of the tariff cap for residential customers in the South-West Coastal Area will be permitted to rise at CPI plus two per cent.

4. The moratorium on Western Power will be varied so that it will not sell or supply gas within all three licence areas other than as follows:

- from October 17, 2003, to any single site that consumes more than 1 TJ per annum;
- from the date of practical FRC in electricity in the South-West Interconnected System, all customers; and
- from July 1, 2007, the Government, following a review by the proposed Economic Regulation Authority, may consider changing the moratorium then on Western Power to permit it to sell or supply gas to more or all customers.

5. AlintaGas will complete development of network information systems necessary for it to participate in FRC within 12 months of the Gas Access Regulator approving that AlintaGas Networks Pty Ltd may recover capital and operating costs associated with the Network Market Information System from access users of the gas distribution network. AlintaGas in its participation in the Retail Market Operator will work towards having in place practical FRC within the same time frame.