



Retail Energy Market Company Limited
ABN 15 103 318 556
228 Adelaide Terrace
Perth WA 6000
Telephone: (618) 6212 1829
Facsimile: (618) 6212 1038
www.remco.net.au

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Mr Allan Dawson
Chief Executive Officer
Independent Market Operator

By e-mail: market.development@imowa.com.au

Dear Allan

Re: Proposed Wholesale Gas Market Development in WA

Retail Energy Markey Company Limited ("REMCo") is the gas retail market operator for Western Australia ("WA").

REMCo has operated the WA gas retail market in a very efficient, stable, and cost-effective manner for over 10 years. REMCo administers the business processes between WA gas retail market participants to enable gas retailers to compete to supply of gas to about 700,000 end-use customers. Further information on REMCo can be found on our website at www.remco.net.au.

As the gas retail market operator for WA, REMCo is concerned with the ongoing development of the WA gas wholesale market; as an efficient gas wholesale market will aid effective operation the State's gas retail market. As a result, REMCo is pleased to make the enclosed submission regarding the Independent Market Operator ("IMO") proposed gas trading mechanism.

I can be contacted on 0421 093 598 or stephen.eliot@remco.net.au if you have any questions or would like to meet to discuss this matter further.

Yours sincerely,

STEPHEN ELIOT
Chief Executive Officer

Attachment: REMCo Submission on the IMO Gas Trading Mechanism

REMC SUBMISSION ON THE IMO GAS TRADING MECHANISM

Conclusions

Retail Energy Market Company ("REMC") has reviewed the need for a gas trading mechanism in Western Australia ("WA"), and has concluded that:

- the current industry-developed gas trading mechanisms may be sufficient to meet the needs of the WA gas market;
- industry is fully capable of developing a new WA gas trading mechanism or modifying the existing mechanisms to meet the needs of the market as they evolve over time; and
- there does not appear to be a need for Government to intervene in the market and require development of another competing gas trading mechanism.

If the WA Government decides to require development of another competing gas trading mechanism, then it should not support the Independent Market Operator ("IMO") proposed mechanism in the first instance, as the IMO appears to have skipped several steps in the consultation process in developing its proposal. Instead, the WA Government should first consult with, or allow industry to consult on its own with:

- current and potential new gas trading mechanism users regarding:
 - what features any gas trading mechanism(s) should have; and
 - which of these features are not provided by existing gas trading mechanisms, if any;
- current and potential new gas trading mechanism operators, including REMCo, regarding:
 - how the needs of the WA gas market can be best met; and
 - how any changes to existing gas trading mechanisms or new gas trading mechanisms can be funded by the users of the mechanism.

Previous Analysis of the Need for a Gas Trading Mechanism in WA

REMC and the Australian Energy Market Operator ("AEMO") have completed an analysis of the potential for a gas Short Term Trading Market ("STTM") in WA. The report on this analysis was published on 1 July 2013, and a copy of the report is available on the REMCo website at:

[http://www.remco.net.au/attachments/article/60/WA%20STTM%20Assessment%20-%20Final%20\(26-06-13\)%20v6.pdf](http://www.remco.net.au/attachments/article/60/WA%20STTM%20Assessment%20-%20Final%20(26-06-13)%20v6.pdf).

Amongst other things, REMCo and AEMO concluded that an upstream trading hub could be implemented in WA, similar to the hub operated by AEMO at Wallumbilla; but there does not appear to be any rationale for such a development, given the industry-developed gas trading mechanisms already operating in WA. REMCo and AEMO recommended that a STTM not be pursued for WA, but that a gas trading mechanism of some form should be reconsidered if:

- the current gas trading platforms in WA no longer provide sufficient price transparency; or
- other market developments arise that warrant reconsideration of a suitable form of gas trading mechanism.

It is unclear whether there have been any gas market developments in WA that would change the conclusion in this analysis, although it is noted that gas is expected to flow into the WA market from new sources in the near to medium-term, and that the suppliers of this gas may benefit from establishing a new gas trading mechanism.

WA Government Consideration of a Gas Trading Mechanism

The WA Government is considering electricity generation fuel issues as part of its current *Electricity Market Review*. The *Electricity Market Review Discussion Paper* (the “Discussion Paper”) was published on 25 July 2014, and suggests that the WA gas market may be too illiquid, and that this may be a barrier to new private sector generation because:

- the major suppliers operate in joint ventures, authorised by the Australian Competition and Consumer Commission (“ACCC”);
- the seven largest gas consumers (Alcoa, Alina Energy, BHP Billiton, Burrup Fertilisers, Citic Pacific, Rio Tinto, and Synergy) use more than 90% of gas traded in WA; and
- while gasTrading Pty Ltd (“gasTrading”) already operates a gas trading mechanism in WA, it only trades about 1% of the State’s daily gas use.

The Discussion Paper concludes that an efficient gas trading market is important for gas buyers and sellers; and asks whether there would be a material benefit in establishing a gas supply hub in WA, and if so, how it should be implemented.

It is reasonable to explore the need for a gas trading mechanism for WA at this juncture, but is premature to begin with development of a specific proposal. Instead, any current and potential new users of a gas trading mechanism should first be consulted on:

- what features that any gas trading mechanism(s) should have; and
- which of these features are not provided by existing gas trading mechanisms, if any.

In asking these questions, it should be noted that the gasTrading mechanism is not the only industry-developed gas trading mechanism in WA; and it is entirely possible that these mechanisms, while relatively small, may meet the current needs of the market:

- the seven largest gas consumers in WA have long-term gas supply contracts and have exhibited a clear ability to source and trade gas variances to meet their day-to-day requirements, and are unlikely to need a gas trading mechanism in the near future;
- while the gasTrading mechanism only trades about 1% of the total market, this represents about 10% of the market that is likely to make use of a gas trading mechanism in the near future; and
- since gasTrading also publishes its trading prices, there may already be sufficient liquidity and price discovery in the WA gas market.

Rationale for a Gas Trading Mechanism in WA

The IMO has developed a proposal for a new WA gas trading mechanism, and has been consulting on this mechanism with its Gas Advisory Board (“GAB”).

The IMO’s proposed gas trading mechanism would compete with a number of existing gas trading mechanisms that have been developed by industry, independent of Government. The IMO has indicated that it is progressing its proposal because the current gas trading mechanisms have a number of issues with:

- independence;
- transparency;
- financial security (prudentials); and
- liquidity.

However, the IMO has not provided any evidence for its claims, REMCo has not observed these issues, and no gas market participants have expressed any such concerns to REMCo.

In moving straight to developing a specific proposal for a gas trading mechanism, the IMO has skipped several necessary steps in the discussion of gas market development in WA, including:

- what are the needs of the WA gas market;
- which of these needs are being met by the current gas trading mechanisms in WA, and which need further development; and
- if there are any needs not currently being met, what is the best way to meet those needs most efficiently and at least cost.

Funding for any Gas Trading Mechanism in WA

The IMO has indicated that its proposed gas trading mechanism will be voluntary, and that:

- all costs will be recovered via variable transaction fees;
- any shortfall in cost recovery for the gas trading mechanism will be covered by the Gas Bulleting Board (“GBB”) fees; and
- based on fees similar to those charged by AEMO for the Wallumbilla gas trading mechanism, the IMO’s mechanism would need to transact about 700TJ/annum to be financially viable.

However, REMCo questions the ability for any new gas trading mechanism to transact anywhere near these gas volumes, at least in the short- to medium-term, given:

- the size of the WA gas market;
- the amount of gas already locked up under long-term contracts;
- the ability of the large gas users to bilaterally trade with one another without the need for a trading mechanism, or to incur costs from such a mechanism; and
- the existence of other gas trading mechanisms that already trade a significant proportion of gas that is not already locked up under long-term contracts.

As a result, it appears that the IMO’s proposed gas trading mechanism would likely require a cross-subsidy from the GBB, at least in the short- to medium-term. This means that, while use of the gas trading mechanism may be voluntary, gas market participants would have to pay for the mechanism irrespective of whether they use it. This highlights the question of the need for the IMO’s proposed gas trading mechanism – that is, does the market need a particular gas trading mechanism if that mechanism cannot economically fund itself?

REMCo also points out that it is highly unusual for one market mechanism to be cross-subsidised by other parts of the market. The AEMO is expressly forbidden from any such cross-subsidy – it sets the fees for its various services in accordance with the *National Electricity Rules* and *National Gas Rules*. The fee for each service is set to cover the costs of that service, plus a proportion of AEMO overheads, and no cross-subsidies are applied to any of AEMO’s market fees.

Other options to finance any new gas trading mechanism would be:

- WA Government funding;
- an up-front subscription fee, potentially with the size of the fee tied to the size of the market participant; and
- the operator of the gas trading mechanism taking out a loan to finance the mechanism, and recovering the costs over a longer period of time – this is how REMCo financed initial development of the WA gas retail market.