

A new era for the electricity industry in Western Australia

Minister for Energy Francis Logan has welcomed the restructure of Western Power, which occurred at midnight on Friday 31 March 2006.

“This was an historic day for Western Australia and its electricity industry”, Mr Logan said. “It was the last day of operation of Western Power as a fully integrated electricity supplier. The four new State-owned electricity corporations began operations on 1 April 2006.”

“The Government has delivered on its long-standing commitment to reform electricity supply in Western Australia, and this represents a fresh start for the companies themselves, and for the State’s electricity consumers.”

The restructure of Western Power sets the stage for a competitive electricity industry, as it will encourage increased private sector investment, put downward pressure on electricity prices, and drive improvements to the reliability of supply.

Rather than one large, bureaucratic entity overseeing all electricity functions, each corporation will be a specialist operator with a much clearer focus and accountability. Minister Logan said that Western Australia’s electricity consumers will be the beneficiaries as the new companies focus on improving operational performance, cost-effectiveness, and customer satisfaction.



Minister for Energy signing the Transfer Order.
Front: the Hon Francis Logan MLA, Minister for Energy
Back: John Bradley (Executive Director, ERIU), Brett Sadler (Principal Policy Advisor), Anne Nolan (Coordinator of Energy) and Simon Thackray (Senior Manager, ERIU).

Introducing the new State-owned electricity corporations:



Synergy is the new energy retailer in the South Western Interconnected System (SWIS).

Phone: Residential 13 13 53 Business 13 13 54 Website: www.synergyenergy.com.au



Horizon Power is responsible for generating or procuring power, and distributing and selling it to customers in areas outside of the SWIS.

Phone: Residential 1800 267926 Business 1800 737036 Website: www.horizonpower.com.au



Verve Energy will generate electricity from power stations located in the SWIS, as well as from some renewable energy plants outside of the SWIS.

Phone: (08) 9424 1888 Website: www.verveenergy.com.au



The **Western Power** name has been retained by the networks business – the business that manages the “poles and wires”. The new Western Power will transport electricity from generators to customers in the SWIS and will also be in charge of restoring power and maintaining and upgrading the network.

Phone: 9326 4911 Website: www.westernpower.com.au

Wholesale Supply between Verve Energy and Synergy

Wholesale supply of power from Verve Energy to Synergy is governed by the Vesting Arrangements. Minister Logan said that all market participants will have access to information about the Vesting Arrangements inherited by Verve Energy and Synergy.

“To ensure that investors in the new market understand their competitive environment, the Government will be publishing most of the details of the Vesting Contracts, which govern electricity supply between Verve Energy and Synergy in the early stages of the market.”

The Vesting Arrangements

The Electricity Reform Task Force recommended that wholesale energy contracts should be established between the Generation and Retail Corporations at the time of Western Power’s disaggregation to:

- provide for supply to the existing retail customers of Western Power;
- mitigate the market power of Western Power’s successor entities; and
- provide for a smooth transition to the new Wholesale Electricity Market.

The Vesting Arrangements took effect from 1 April 2006, and are comprised of: the Vesting Contract and a Ministerial Direction issued under the *Electricity Corporations Act 2005*.

The Vesting Contract

The Vesting Contract provides initial wholesale supply to meet the following sales obligations inherited by Synergy:

- customers that are not contestable and are supplied on a published tariff;
- customers that are contestable, but remain on a published tariff rather than accept a retail sales agreement; and
- customers that are on contestable retail sales agreements that Synergy inherited from Western Power.

While the Vesting Contract initially covers a significant proportion of wholesale supply in the SWIS, the contract volumes will decline automatically as the electricity market becomes more competitive. The Vesting Contract volume will decline as:

- retail sales agreements that are inherited by Synergy expire;
- contestable tariff customers accept retail sales agreements from any retailer; and
- Synergy undertakes displacement in accordance with the “Displacement Mechanism” (see below).

Some of the key features of the Vesting Contract are discussed below:

Netback Pricing:

Pricing is based on a “netback calculation”, which means that efficient retail, networks, and regulatory costs are deducted from sales, and Verve receives the residual. That is, the amount to be paid by Synergy to Verve Energy is calculated as:

- the revenue Synergy receives from the relevant tariff and contract sales;
- less a defined allowance for Synergy’s costs, including an efficient profit margin, which is retained by Synergy;
- less networks costs paid to Western Power; and
- less other specified market and regulatory costs.

The Displacement Mechanism:

- The Vesting Contract contains a Displacement Mechanism that requires Synergy to expose the contract volumes to competitive sourcing outside of the Vesting Contract. The displacement will occur through:
 - “negotiated” arrangements, which Synergy may enter into at any time, up to specified limits; and
 - “tendered” arrangements, which occur in a scheduled, orderly tender process.

The Displacement Mechanism will gradually reduce the amount of electricity traded under the Vesting Contract, and will force both Synergy and Verve Energy into the Wholesale Electricity Market.

The Contract Administrator:

The Minister for Energy, or a person delegated by the Minister, will administer the Vesting Contract. The Contract Administrator will annually recalculate specific volume and price terms under the Vesting Contract, using formulae in the schedules to the contract.

The Contract Administrator is also to:

- make determinations on the roll forward or backward, and on deferrals under the Displacement Mechanism, and
- resolve any issues that may arise under the Vesting Contract, such as force majeure, changes in law, or changes in the Wholesale Market Rules.

Balancing Hedge:

The Vesting Contract includes a financial hedge to manage Synergy's risk in the balancing market, but also exposes Synergy to increased costs for excessive nomination errors as a means to provide it with an incentive to forecast accurately.

The Displacement Mechanism Ministerial Direction

The Ministerial Direction is to ensure that the tender processes that Synergy is to undertake under the Displacement Mechanism are open and fair; and that the market is provided with appropriate information to participate in the tender processes. The key features of the Ministerial Direction are:

The Tender Process:

The Ministerial Direction specifies the guidelines that Synergy must follow in running the tender process under the Displacement Mechanism. This includes that Verve Energy must be treated equally with all other tenderers and is not to be afforded any special treatment or benefit.

The Annual Displacement Statement of Opportunities:

The Ministerial Direction specifies that Synergy must annually publish certain information, such as the volumes that will be available for future tenders, and the average vesting price. These statements are to provide bidders in the tender processes with appropriate information to make bids. Synergy is to publish these statements by 30 November, with the first such statement to be published in 2006.

Further Information

Further information on the Vesting Arrangements is available on the Office of Energy website (www.energy.wa.gov.au).

Copies of the Vesting Contract (excluding prices) are available on the Office of Energy, Synergy, and Verve Energy websites.

A copy of the Ministerial Direction is also available on the Office of Energy and Synergy websites.

What does the restructure mean for customers?

All existing Western Power accounts for customers within the SWIS will automatically transfer to Synergy; and all customers outside of the SWIS will automatically transfer to Horizon Power. Western Power's current electricity customers will not need to do anything as a result of the restructure.

"The Government remains committed to ensuring that small business and residential electricity tariffs are not increased during this term," Mr Logan said. "The Government has frozen small business and residential electricity tariffs until 2009."

At this stage, residential and small business customers consuming less than 50 MWh per annum are not contestable, and will remain supplied by Synergy or Horizon Power. However, about 60% of the south west market is open to retail competition, and 12,500 customers may currently choose their electricity supplier.

Minister Logan said "While competition will develop over time, strong regulatory arrangements have been put in place to protect the interest of small customers."

The Government has also established a number of customer protection mechanisms including a Customer Service Code, the Energy Ombudsman scheme, and standard terms and conditions for customer contracts.

The Transfer Order

The Transfer Order is the statutory mechanism used to transfer Western Power's assets, rights and liabilities to the Successor Entities.

The Transfer Order was based upon a similar mechanism used to restructure the State Energy Commission of Western Australia to create Western Power and AlintaGas on 1 January 1995.

The Transfer Order allocated more than 8,000 individual records or Transfer Items as identified by Western Power in a Central Register.

The Office of Energy and the State's legal advisors undertook a comprehensive due diligence review to verify the information in the Central Register. The Office of Energy and Western Power determined the allocation of the Transfer Items to the Successor Entities.

The Minister for Energy endorsed the Transfer Order, and it was published in the Government Gazette on 31 March 2006, to provide for the disaggregation to take effect on 1 April 2006. A copy of the Transfer Order is available for inspection from the Office of Energy.

The Continuation of Electricity Reform

Minister Logan said that the next step in the electricity reform program is the implementation of the Wholesale Electricity Market in July 2006.

"For the first time, Western Australia will have a sophisticated electricity trading market and the new government owned corporations will be on a strong commercial footing to compete in that market.

The Wholesale Electricity Market will be operated by the Independent Market Operator, and will provide a mechanism for industry participants to trade in electricity.

The start of the Wholesale Electricity Market will not mark the end of the electricity market reform. The Government is committed to reviewing the potential for Full Retail Contestability, as the wholesale market becomes competitive. This would allow all retail customers, including residential customers, to choose their own electricity supplier. The Office of Energy will also continue to develop new electricity reform initiatives to improve customer outcomes.

New Market Power Mitigation Measures

In addition to the Vesting Contract, the Government has taken significant steps to protect market participants from the abuse of market power.

Western Power's generation capacity was previously capped at 3,000 MW under a Ministerial Direction issued in April 2005. This capacity cap was to promote the development of a competitive electricity market.

With the disaggregation of Western Power this Ministerial Direction has been replaced with separate directions on Verve Energy and Synergy.

The Ministerial Direction on Verve Energy

The Ministerial Direction on Verve Energy restricts its future investment and contracting arrangements. This is intended to give new market entrants the confidence to invest significant capital in generating assets. The new Ministerial Direction on Verve Energy:

- retains the "nameplate" capacity cap of 3,000 MW;
- clarified that if Verve Energy becomes the registered Market Generator for third party generation plants, the capacity for that plant counts towards Verve Energy's capacity under the 3,000 MW cap;
- requires Verve Energy to maintain and make available sufficient generating capacity to maintain the security and reliability of the SWIS until 1 October 2007; and
- contains a number of exemptions to enable Verve Energy to undertake investment when it is consistent with the Government's policy objectives.

The Ministerial Direction on Synergy

Under the *Electricity Corporations Act 2005*, there is a prohibition on Synergy owning and operating generation plant. The Ministerial Direction on Synergy clarifies that this prohibition extends to contractual arrangements that would result in Synergy becoming a registered Market Generator.

Further Information

Both Ministerial Directions can be viewed on the Office of Energy website www.energy.wa.gov.au.



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