



# Notice

30 October 2015

## First Investigation into Vinalco's Pricing Behaviour

The Economic Regulation Authority (**ERA**) has investigated the behaviour of Vinalco Energy Pty Ltd (**Vinalco**) that was identified in advice from the Independent Market Operator (**IMO**), pursuant to clause 2.16.9E of the Wholesale Electricity Market Rules received on 23 June 2014 (**First Investigation**).

### Background

The Wholesale Electricity Market (**WEM**) in Western Australia operates under the *Electricity Industry Act 2004*, *Electricity Industry (Wholesale Electricity Market) Regulations 2004*, and *Wholesale Electricity Market Rules (Rules)*.

Electricity generators that are registered with the IMO make offers into the balancing market (which is a component of the WEM) to supply electricity for 30 minute trading intervals. These offers are known as balancing submissions.

In accordance with Rule 7A.2.17, Market Participants must not, for any trading interval, offer prices in balancing submissions in excess of their reasonable expectation of the short run marginal cost (**SRMC**) of generating the relevant electricity, when such behaviour relates to market power.

Under Rule 2.16.9B, the IMO must refer the behaviour of a market generator to the ERA for investigation if the IMO:

- concludes that prices offered by the market generator in its balancing submission may exceed its reasonable expectation of the SRMC of generating the relevant electricity; and
- considers that this behaviour relates to market power.

Where the ERA receives such advice from the IMO, Rule 2.16.9E requires that the ERA must investigate the identified behaviour. Rule 2.16.9F requires that the ERA must publish the results of its investigation.

Under Rule 2.16.9G, where the ERA determines that prices in a balancing submission, subject to the investigation, exceeded the market generator's reasonable expectation of the SRMC of generating the relevant electricity, the ERA must request that the IMO apply to the Electricity Review Board for an order for contravention of clause 7A.2.17.<sup>1</sup>

Under Rule 2.16.9H, the IMO must refer the relevant matter to the Electricity Review Board requesting that a civil penalty be imposed on the relevant market generator, when it receives a request from the ERA under Rule 2.16.9G.

<sup>1</sup> Rule 2.16.9G (b) does not mention market power as a criterion for the ERA to refer behaviour to the IMO. However, the ERA considers that it should only refer behaviours potentially in breach of Rule 7A.2.17 to the IMO.

It is not the role of the ERA to determine whether or not a generator has contravened Rule 7A.2.17. This is the role of the Electricity Review Board.

### **Pricing behaviours referred by the IMO to the ERA**

On 23 June 2014, the IMO submitted advice to the ERA under Rule 2.16.9B, which stated that the IMO had concluded that:

- prices offered by Vinalco in its balancing submissions during the period 23 February 2014 to 24 March 2014<sup>2</sup> (**First Investigation Period**) may have exceeded Vinalco's reasonable expectation of the SRMC of generating the relevant electricity; and
- the behaviour relates to market power.

The pricing behaviour identified by the IMO related to Vinalco's four Muja AB generators.

There were a total of 1,440 Trading Intervals during the First Investigation Period, during which Vinalco units were dispatched 2,631 times.

An unusual set of circumstances applied to Vinalco during the First Investigation Period. Transformer failures at the Muja substation in September 2012 and February 2014 caused issues with the reliability of electricity supply to the Great Southern region. Consequently, System Management (which is part of Western Power) required Vinalco to operate its Muja AB plant continuously to ensure the reliable supply of electricity to the Great Southern region during the First Investigation Period. This is known as being 'constrained-on-out-of-merit' by System Management. The ERA has taken this into account in conducting its investigation.

The ERA received full and open co-operation from Vinalco, its owner Synergy and System Management during its investigation.

### **ERA's approach and findings**

This is the first time that the IMO has referred behaviour by a market participant to the ERA for investigation under Rule 2.16.9E.

In conducting this investigation into Vinalco's pricing behaviour, the ERA was required to determine whether:

- Vinalco offered prices above its reasonable expectation of the SRMC of generating the relevant electricity; and
- that behaviour relates to market power.

The ERA found that Vinalco offered prices above its reasonable expectation of the SRMC in all trading intervals in the First Investigation Period.

The specific market in which the ERA found that Vinalco operated was the market to provide support to System Management to ensure the reliability of supply to the Great Southern region (that is, when Vinalco was constrained-on-out-of-merit). The ERA found that this was a separate market to the WEM and this market was not competitive (in the context of Rule 7A.2.17) during the First Investigation Period because Vinalco was not constrained by the behaviour of competitors or customers.

The ERA concluded that Vinalco had market power during the First Investigation Period in the market for system support to the Great Southern region in the context of Rule 7A.2.17.

However, the ERA considers that a generator in Vinalco's situation should be able to recoup its relevant costs incurred in providing the electricity. Due to the economics of electricity generation

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<sup>2</sup> A trading interval is a half hour interval in the Wholesale Energy Market. A Trading Day is a period of 24 hours starting at 8:00 AM and concluding at 8:00 AM the following day. Each Trading Day has 48 half hour trading intervals starting from 8:00 AM to 7:30 AM the following day. The investigation period covers trading intervals from 8:00 AM on 23 February 2014 (calendar date 23 February 2014) to 7:30 AM on 24 March 2014 (calendar date 25 March 2014).

and the technical definition of SRMC, Vinalco would have incurred short-run losses in providing the relevant electricity if it offered prices at its reasonable expectation of the SRMC.

This is inconsistent with the objectives of the wholesale electricity market. Therefore, Vinalco's price offers above its reasonable expectation of the SRMC might not have been related to any market power it held during the Investigation Period.

Taking this into account, the ERA applied subsequent tests to determine whether Vinalco would have offered the same or higher prices during the First Investigation Period if it did not have market power.

As a result of its investigations, the ERA determined that, of the approximately 2,631 times Vinalco units were dispatched across the First Investigation Period, Vinalco offered 118 prices from Muja\_G4, 85 prices from Muja\_G3, and 15 prices from Muja\_G1 that:

- exceeded Vinalco's reasonable expectation of the SRMC of generating the relevant electricity; and
- this behaviour related to market power.

In accordance with Rule 2.16.9G, the ERA will request that the IMO apply to the Electricity Review Board for an order for contravention of Rule 7A.2.17 in relation to these price offers.

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