



Ref: LE-717-140620

20 June 2014

Allan Dawson
Chief Executive Officer
IMO
Level 17
197 St Georges Terrace
Perth WA 6000

CONFIDENTIAL COMMUNICATION

Dear Mr Dawson

**VINALCO ENERGY PTY LTD – BALANCING SUBMISSIONS
REQUEST FOR EXPLANATION UNDER CLAUSE 2.16.9B(C) OF MARKET RULES**

We are writing to provide the Independent Market Operator (**IMO**) an explanation under clause 2.16.9B of the Wholesale Electricity Market Rules (the **Market Rules**), as requested by you by letter dated 18 June 2014.

Vinalco Energy Pty Ltd (**Vinalco**) is disappointed that the IMO has decided to escalate this matter, in circumstances where System Management has required that Vinalco provide system support to resolve or avoid network issues resulting from the failure of Transformers BTT1 & BTT2, and Vinalco has met those requirements. Vinalco has yet to receive a response from the IMO as to whether it considers that the continuous dispatch of the Muja AB Facilities by System Management Out of Merit is permitted or appropriate under the Market Rules, when Western Power has responsibility for the maintenance of the SWIS and, in any event, other mechanisms such as a Network Control Service Contract or Ancillary Service Contract are clearly more appropriate to deal with the present circumstances.

If System Management did not purport to dispatch Vinalco Out of Merit, Vinalco expects that the Muja AB Facilities would not have been dispatched in the Balancing Merit Order to meet the additional generation required by System Management to mitigate the effects of Western Power's transformer failure. However, despite Vinalco's reservations about System Management's right to require Vinalco to provide system support over a prolonged period in this manner, Vinalco co-operated in the interest of assisting to preserve a reliable operating state in the affected part of the SWIS. Vinalco repeats its concerns about whether the Market Rules give System Management the power to require a Market Participant to provide prolonged support in this manner. Vinalco is considering the Market Rules further, and reserves the right to stop providing system support in the future.

Putting those matters aside, for the reasons set out below, Vinalco does not accept that, on a proper construction of the Market Rules:

1. it has market power; or
2. the prices offered in the relevant Balancing Submissions "relate to market power"; or
3. the prices offered are in excess of its reasonable expectation of the short run marginal cost of generating the relevant electricity (which, in any event, Vinalco was free to price above).

Vinalco does not have market power

The fact that Vinalco was dispatched by System Management in respect of the Muja AB Facilities Out of Merit (ie regardless of any competing offer) does not establish that Vinalco has market power, or that this pricing behaviour "relates to market power".

The IMO has not identified the relevant market in which Vinalco is said to have market power. Nor has it identified any link between the alleged market power and Vinalco's pricing conduct. The fact that Vinalco is dispatched Out of Merit is the result of a regulatory decision taken by System Management, not Vinalco.

That regulatory decision is incapable of conferring market power on Vinalco. The fact that the Muja AB Facilities **would not have been dispatched**, but for System Management's regulatory intervention, demonstrates that Vinalco did not and has no market power in any relevant sense.

Vinalco's prices do not relate to market power

As the IMO should be aware from previous correspondence, Vinalco has sought to price at a level that will enable it to operate the Muja AB Facilities economically and efficiently, and to avoid incurring a loss. The prices offered by Vinalco have nothing to do with market power (which, in any event, Vinalco denies having).

Despite this, as previously advised to the IMO, Vinalco estimates that it has incurred significant losses in providing system support, primarily due to the way that the IMO calculated the Constrained On Payments. By way of illustration, as previously advised, Vinalco's initial calculations indicate that it has made a loss of approximately \$744,000 in March 2014 as a direct result of being directed to provide system support services. Those losses increased to approximately \$1,055,904 in April 2014.

Short Run Marginal Cost model

As acknowledged in your letter, Vinalco voluntarily provided the IMO with its Short Run Marginal Cost (SRMC) model. This model is designed to estimate prices at which Vinalco will be able to recover its reasonable expectation of SRMC. However, as indicated above, Vinalco made considerable losses during March and April.

However, and in any event, Vinalco maintains that clause 7A.2.17 does not apply to Vinalco, as it does not have market power, and its prices do not relate to market power. It would be open for Vinalco to price at the Price Cap, and Vinalco reserves its rights to do so in the future.

Yours sincerely



Paul Gower
GENERAL MANAGER OPERATIONS
VINALCO ENERGY PTY LTD