THE WESTERN AUSTRALIAN ELECTRICITY REVIEW BOARD

No. 1 of 2019

BETWEEN:

ECONOMIC REGULATION AUTHORITY

Applicant

and

ENERGY GENERATION AND RETAIL CORPORATION

Respondent

APPLICANT'S STATEMENT OF FACTS, ISSUES AND PRINCIPAL CONTENTIONS

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PRELIMINARY

In this document, capitalised terms, unless otherwise indicated, have the same meanings as those terms in Chapter 11 of the Wholesale Electricity Market Rules (**Market Rules**).

A. FACTS

(1) Parties

1. The Applicant, the Economic Regulation Authority (the **ERA**), is a statutory body corporate established under section 4 of the *Economic Regulation Authority Act 2003* (WA).

2. The Respondent, the Electricity Generation and Retail Corporation, trading as Synergy (**Synergy**):

(a) is a statutory corporation established under section 4(1)(a) of the *Electricity Corporations Act 2005* (WA) and renamed under section 4(2A) of that Act;

(b) is a Market Participant under the Market Rules;

(c) is registered under the Market Rules as a Market Generator;

(d) operates a portfolio of generation assets comprising 30 generators of different fuel types, being the Balancing Portfolio.

(2) The Wholesale Electricity Market (WEM)

3. The Wholesale Electricity Market (**WEM**) operates as the energy and capacity market for the South-West Interconnected System (**SWIS**), and provides several means by which electricity generators and wholesale purchasers of electricity, including retailers, can purchase and sell electricity and generation capacity on a wholesale basis.

4. Pursuant to section 123 of the *Electricity Industry Act 2004* (WA), the WEM is governed by the Market Rules, as made and amended from time to time pursuant to the *Electricity Industry (Wholesale Electricity Market) Regulations 2004* (**WEM Regulations**).

5. Clause 1.2.1 of the Market Rules prescribes the following market objectives for the WEM:

(a) to promote the economically efficient, safe and reliable production and supply of electricity and electricity related services in the SWIS;

(b) to encourage competition among Market Generators and retailers in the SWIS, including by facilitating efficient entry of new competitors;

(c) to avoid discrimination in the WEM against particular energy options and technologies, including sustainable energy options and technologies such as those that make use of renewable resources or that reduce overall greenhouse gas emissions;

(d) to minimise the long-term cost of electricity supplied to customers from the SWIS;

(e) to encourage the taking of measures to manage the amount of electricity used and when it is used (**Wholesale Market Objectives**).

6. In order to meet the Wholesale Market Objectives, the Market Rules provide for a number of different mechanisms by which Market Participants are able to trade with each other, in relation to their electricity requirements in the SWIS, including:

(a) the Reserve Capacity Mechanism;

(b) Bilateral Contracts;

(c) the Short Term Electricity Market (**STEM**);

(d) the Balancing Market;

(e) the Load Following Ancillary Services (**LFAS**) Market;

(f) Ancillary Services.

7. The Reserve Capacity Mechanism:

(a) entitles Market Generators to payments for having installed capacity available (even if it is not called upon to generate);

(b) is intended to encourage an efficient quantity of generation capacity available each year to meet peak electricity demand within the SWIS, including an appropriate amount of excess capacity (or reserve margin), as well as an efficient configuration of generation capacity between base load, mid-merit and peaking plant;

(c) derives the payments for capacity by reference to the capital and fixed operating and maintenance costs of peaking facilities.

8. The Balancing Market is a compulsory price-based dispatch and settlement process that provides for settlement of differences as between the contracted position of Market Generators and the actual electricity generated and dispatched by each Market Generator in respect of each Trading Interval. A Trading Interval is a period of 30 minutes commencing on the hour or half-hour during a Trading Day. A Trading Day is a period of 24 hours commencing at 8:00 am.

9. As part of the Balancing Market, a Market Generator is obliged to submit a Balancing Submission to the Australian Energy Market Operator (**AEMO**) by 6:00 pm on a Scheduling Day in respect of each Trading Interval on the next Trading Day. Synergy can update its Balancing Submissions four times in a 24 hour period.

10. A Balancing Submission consists of a series of offers of prices and quantities (Balancing Price-Quantity Pairs) of electricity for which a Market Generator is willing to be dispatched.

11. Under the Market Rules, unless a Market Generator is part of Synergy's Balancing Portfolio, a Market Generator is required, by section 7A.2 of the Market Rules, to make a Balancing Submission for each Balancing Facility in the Balancing Market to supply electricity for each Trading Interval. Balancing Submissions must be submitted in accordance with section 7A.2 of the Market Rules.

12. The Market Rules allow Synergy to operate the Balancing Portfolio as a single Balancing Facility in the Balancing Market.

13. Synergy submits a single series of Balancing Price-Quantity Pairs for the Balancing Portfolio for each Trading Interval by aggregating costs across the Balancing Portfolio.

14. Synergy submits its offers for each Trading Interval in a series of up to 35 price-quantity tranches that are greater than or equal to the price of its previous offer in the tranche.

15. Market Generators are selected to dispatch electricity in the Balancing Market based on the price competitiveness of their Balancing Submissions. This is referred to as the Balancing Merit Order (**BMO**). The price at which demand meets supply is the Balancing Price. The Balancing Price (that is, the price paid for the last unit of electricity dispatched to meet demand in a particular Trading Interval) is paid to all generators dispatched in the BMO in the particular Trading Interval in the Balancing Market, regardless of the price offered by each generator in its Balancing Submissions.

(3) The ERA's investigation

16. Clause 2.16.9 of the Market Rules provides that the ERA is responsible for monitoring the effectiveness of the WEM in meeting the Wholesale Market Objectives, and must investigate any market behaviour if it considers that the behaviour has resulted in the market not functioning effectively. That function includes, by clause 2.16.9(b) of the Market Rules, monitoring certain prices offered by a Market Generator.

17. Clause 7A.2.17 of the Market Rules prohibits Market Participants, for any Trading Interval, from offering prices in their Balancing Submissions in excess of their reasonable expectation of the short run marginal cost (**SRMC**) of generating the relevant electricity by the Balancing Facility, when such behaviour relates to market power.

18. Clause 2.16.9B(aA) of the Market Rules states that, where the ERA concludes that prices offered by a Market Generator in its Balancing Submission may exceed the Market Generator's reasonable expectation of the SRMC of generating the relevant electricity, and the ERA considers that the behaviour relates to market power, the ERA must as soon as practicable request an explanation from the relevant Market Participant and investigate the identified behaviour.

19. If, following an investigation under clause 2.13.10 of the Market Rules, the ERA reasonably believes that a Market Participant has breached clause 7A.2.17 of the Market Rules, the ERA may bring proceedings against it before the Electricity Review Board pursuant to clause 2.13.18 of the Market Rules.

20. On 26 July 2017, pursuant to clause 2.16.9B(aA) of the Market Rules, the ERA requested an explanation from Synergy in respect of prices offered by Synergy in its Balancing Submissions made in 14,812 Trading Intervals during the period 31 March 2016 to 10 July 2017 (**Investigation Period**) and informed Synergy that it was investigating those offers.

21. On 28 July 2017, Synergy provided an explanation to the ERA, which was published on the ERA's website pursuant to clause 2.16.9C of the Market Rules.

22. The ERA examined the prices offered by Synergy in Balancing Submissions for Trading Intervals between 6:00 am and 11:30 pm each day during the Investigation Period where the price offered exceeded $40/MWh.

23. On 8 June 2018, the ERA provided its draft investigation report and model to Synergy for review and comment. Synergy provided its response to the draft investigation report together with a report from its consultant [redacted], on 3 September 2018. The ERA considered the response provided by Synergy in forming its conclusion as to whether Synergy breached clause 7A.2.17 of the Market Rules.

24. Following Synergy's comments, a further and final draft investigation report was produced by the ERA, which was provided to Synergy on 7 February 2019 for comment.

25. The ERA reasonably believes that the prices offered by Synergy in its Balancing Submissions for 12,908 of the 14,812 Trading Intervals investigated exceeded Synergy's reasonable expectation of the SRMC of generating the relevant electricity and that the behaviour was related to market power. This breached clause 7A.2.17 of the Market Rules which is a Category C Market Rule.

26. Pursuant to clause 2.13.18 of the Market Rules, on 31 May 2019, the ERA applied pursuant to regulation 32(1) of the WEM Regulations to the Electricity Review Board for:

    (a) an order that Synergy has contravened clause 7A.2.17 of the Market Rules in respect of the prices offered in its Balancing Submissions for the 12,908 Trading Intervals during the Investigation Period;

    (b) an order that Synergy pay a civil penalty;

    (c) an order that Synergy pay the ERA's costs;

    (d) an order that Synergy takes such action as the Electricity Review Board requires to prevent a reoccurrence of the contravention of clause 7A.2.17 of the Market Rules;

    (e) any other orders that the Electricity Review Board thinks fit.

27. Clause 2.16.14 of the Market Rules does not permit information collected under an investigation to be used for the purposes of bringing proceedings. To enable the ERA to use any information collected during its investigation in any subsequent proceedings, on or about 27 November 2017, the ERA commenced parallel investigations under clauses 2.16.9B(aA) and 2.13.10(b) of the Market Rules. Synergy consented to the ERA adopting this course.

(4) Market circumstances relevant to the investigation and proceedings

28. In the 2016/17 Capacity Year, Synergy held approximately 48.6 per cent of total accredited generation capacity in the WEM.

29. In the 2016 calendar year, Synergy generated approximately 47.7 per cent (loss factor adjusted) of the total dispatched energy in the Balancing Market.

30. Synergy participates in gas markets in Western Australia. In contrast to its electricity activities, which are restricted to the SWIS, Synergy's gas trading is not legislatively restricted to a particular geographical area. Synergy sources gas to cover a range of gas demands, including for electricity generation, trade and storage.

31. The average daily spot price for gas during the Investigation Period was $4.29/GJ (undelivered).

32. Synergy uses the Mondarra storage facility to store and extract gas to manage its daily quantity requirements and manage supply and demand fluctuations. Synergy's share of the available storage at the Mondarra storage facility was [redacted].

33. The Department of Mines, Industry Regulation and Safety (**DMIRS**) publishes Western Australian average domestic gas prices annually.

34. The DMIRS data indicates that gas prices:

    (a) trended upwards after 2010, but thereafter remained relatively flat until the middle of the 2016 calendar year; and

    (b) began falling from the middle of the 2016 calendar year, at or about the time that Synergy revised and increased its gas input price used to calculate its SRMC.

35. The AEMO publishes the Western Australian Gas Statement of Opportunities (**GSOO**) annually which contains forecasts of gas supply and demand and identifies any emerging issues affecting the gas industry.

36. The GSOO published in November 2015, forecast gas supply for the period 2016 to 2025 remaining significantly higher than forecast demand.

37. The GSOO published in December 2016 stated that the WA domestic gas market was expected to be well supplied, with potential gas supply expected to remain higher than forecast gas demand over the outlook period.

38. From 31 March 2016 to 10 July 2017, Synergy entered into 11 new industrial gas sale agreements to supply gas to industrial customers. The gas price in the new industrial gas sale agreements, for all except one of the new gas sales, was between [redacted]. The higher-cost agreement was a long-term contract with [redacted], starting with a price of [redacted] in December 2016.

39. The average gas price received by Synergy for industrial gas sale agreements executed during the Investigation Period was [redacted], excluding the gas price in the [redacted] contract.

40. At the start of the Investigation Period, Synergy had:

(a) a pre-existing gas supply agreement under which it was supplied gas from [redacted] which expired in December 2016;

(b) a contract which it had entered in November 2011 from [redacted] for the supply of gas in preparation for the expiry of the [redacted] Contract ([redacted] **Contract**).

41. The contract price for gas under the [redacted] Contract was [redacted].

42. The [redacted] was scheduled to deliver gas to Synergy from 31 December 2015, but did not begin to do so until 6 December 2016.

43. The [redacted] Contract included a high take-or-pay portion (90 per cent of the total volume of [redacted]) priced at approximately [redacted]. Synergy, at its discretion, could elect to take the remaining variable quantity, which was similarly priced.

44. In December 2016, during the transition period between the [redacted] Contract and the [redacted] Contract, Synergy had access to the take-or-pay and discretionary tranches of gas available under both the [redacted] Contract and [redacted] Contract, totalling [redacted].

45. On 16 June 2016, Synergy entered into a gas swap arrangement with [redacted] (**Gas Swap Arrangement**) consisting of two periods:

(a) a substitution period [redacted]

(b) a supply period [redacted].

46. [redacted] Supply from Synergy to [redacted] commenced on 1 December 2016 and the substitution period was extended until 1 January 2018.

47. On 20 July 2016, Synergy entered into a new gas supply contract to purchase an average [redacted] from [redacted].

48. In January 2017, Synergy entered into a new gas supply contract with its suppliers [redacted] to purchase up to [redacted] in a price range of [redacted].

(5) Synergy's change to input costs

49. On 11 May 2016, in response to the ERA's routine market monitoring functions, Synergy notified the ERA that it had revised its start-up costs used to calculate its SRMC for electricity generation.

50. On 8 August 2016, Synergy notified the ERA that it had revised its gas fuel cost and updated its gas input price used to calculate its SRMC for electricity generation.

51. Start-up costs and gas fuel costs are the two major input costs used to determine Synergy's SRMC for the Balancing Portfolio during the Trading Intervals investigated by the ERA.

52. There is a direct relationship between the input costs Synergy used to calculate its SRMC, such as the gas input price and start-up costs, and the prices offered in Balancing Submissions by Synergy in the Trading Intervals investigated by the ERA.

53. The changes to Synergy's input costs were:

    (a) the recalculation of the gas input price used to calculate Synergy's SRMC and determine the prices offered in its Balancing Submissions, [redacted];

    (b) the recalculation of Synergy's start-up costs used to calculate Synergy's SRMC and determine the prices offered in its Balancing Submissions. The revised start-up costs used by Synergy were significantly higher than Synergy's start-up costs using its previous method of calculation and exceeded Synergy's actual start-up costs by at least 20% to 172%, depending on the generator.

(a) Change in calculation of gas input price

54. SRMC input costs include fuel costs, such as gas fuel costs. Gas fuel costs are a significant component of Synergy's SRMC of generating electricity when Synergy's gas fired generators are being dispatched as part of the Balancing Portfolio.

55. The gas input prices used by Synergy to calculate its SRMC during the Investigation Period were:

    (a) [redacted] from 1 April 2016 to 13 July 2016 (**Period 1**);

    (b) [redacted] from 14 July 2016 to 30 November 2016 (**Period 2**);

    (c) [redacted] from 1 December 2016 to 10 July 2017 (**Period 3**).

56. As Synergy advised the ERA, throughout the Investigation Period Synergy calculated gas input prices on an opportunity cost basis, (i.e., by calculating the next most valuable use of the gas).

Period 1

57. In Period 1, Synergy applied a gas input price of [redacted] to calculate its SRMC of generating electricity, made up of:

    (a) the contract price for gas under the [redacted] Contract at [redacted]; plus

    (b) an opportunity cost allowance of [redacted].

58. During Period 1, Synergy calculated its opportunity cost of gas based on the contract price Synergy paid for the gas under the [redacted] Contract, plus its estimate of an additional amount for which Synergy could have sold the gas, on the basis that this represented the next most valuable use of the gas, had it not used the gas to produce electricity.

Period 2

59. In Period 2, Synergy applied a gas input price of [redacted] to calculate its SRMC of generating electricity.

60. Synergy changed the way it calculated its opportunity cost of gas in Period 2 from the amount Synergy could have obtained selling the gas on the spot market, to the amount that Synergy could have obtained storing the gas for sale in a future period, or entering a swap for a future period.

61. The justification offered for this change in methodology between Period 1 and Period 2, was that Synergy considered that gas prices would rise in the future, making it more profitable to store or swap gas rather than sell it on the open market.

62. In calculating the opportunity cost of gas in Period 2, Synergy:

    (a) assumed a storage rate injection of [redacted], and that it could extract up to [redacted] at the Mondarra storage facility for [redacted]

    (b) increased its estimate of industrial gas market sales from [redacted];

    (c) treated all industrial gas market sales as having a contract-break cost of [redacted], and therefore unavoidable;

    (d) on the basis of (a) to (c), allocated all the gas it had contracted to buy through the take-or-pay portion of the [redacted] Contract, which had zero opportunity cost, to industrial gas sales and storage;

    (e) for the purposes of estimating the future price of gas stored or swapped applied the price of the variable gas tranche in the [redacted] Contract, that is, [redacted].

Period 3

63. The gas input price applied by Synergy to calculate its SRMC of generating electricity varied between [redacted] during Period 3.

64. In Period 3, Synergy continued to calculate its opportunity cost of gas on the basis of the amount that Synergy could have obtained for storing the gas for sale in a future period, or entering a swap for a future period.

65. In calculating the opportunity cost of gas in Period 3, Synergy:

    (a) continued to assume a storage rate injection of [redacted], other than in December 2016 where it assumed a storage rate injection of [redacted], notwithstanding the fact that by the beginning of Period 3 the Mondarra storage facility was almost full;

    (b) increased its estimate of industrial gas sales in Period 3 by [redacted] to reflect the start of its supply obligations under the Gas Swap Agreement;

    (c) continued to treat all industrial gas market sales as having a contract-break cost of [redacted], and therefore unavoidable;

    (d) treated a total of [redacted] (and [redacted] in December 2016) as being unavoidable demand for gas ([redacted] for storage plus [redacted] for industrial sales);

    (e) on the basis of (a) to (d), allocated all the gas it had contracted to buy through the take-or-pay portion of the [redacted] Contract, which had zero opportunity cost, to industrial gas sales and storage;

    (f) for the purposes of estimating the future price of gas stored or swapped applied the price of the variable gas tranche in the [redacted] Contract, which was between $[redacted].

(b) Updated Generator Start-up Costs

66. On 11 May 2016, Synergy wrote to the ERA to inform it that it had updated its start-up costs used to calculate its SRMC of generating electricity and determine the prices offered in its Balancing Submissions from 16 April 2016 onwards.

67. The update resulted from a review by Synergy of the costs used to determine its start-up costs and a change in the maintenance arrangement of its Open Cycle Gas Turbine generators from an “operating regime” to a “starts regime”.

68. Synergy's proposal for the recovery of its start-up costs over the life of its facilities was not aligned to Synergy's plant inspections, nor did it vary to take into account the expected end of life of each relevant generator in the Balancing Portfolio.

69. Synergy's updated start-up costs applied from 16 April 2016 until the end of Period 1, during the entirety of Period 2 and the entirety of Period 3.

(6) Costs included in Synergy's start-up costs

70. Synergy's start-up costs are made up of fuel and non-fuel costs. Fuel costs are the cost of the fuel consumed as part of the start-up of the generator. Non-fuel costs are made up of variable operating and maintenance costs, including the cost of replacing capital parts of a generator. Variable operating and maintenance costs account for approximately 95% of the total start-up costs for Synergy's gas fired generators.

71. When a generator is started, it wears the capital parts of the generator. Across the lifetime of the generator, capital parts may be required to be replaced. This replacement cost is generally spread across the life of the capital part. To determine the cost, assumptions are made in respect of two matters:

    (a) the number of starts;

    (b) the life of the generator.

72. Replacement cost can be contrasted with the recovery of the initial capital costs, which is provided for through the reserve capacity mechanism and via any surplus a Market Generator is able to earn from the Balancing Market when higher-cost generation is required to be dispatched to meet demand.

73. Synergy calculated the cost per start of the capital parts of its facilities by dividing the total cost of the part by the manufacturer-rated number of lifetime starts for that part to create a "cost per start".

74. Synergy annualised this cost by multiplying the cost per start for each start expected in the year.

75. Synergy estimated the number of expected starts in the year on a Facility basis. Where a Facility was made up of a number of generating units (e.g., Pinjar 9, Pinjar 10 and Pinjar 11) Synergy estimated the starts required for each generating unit and then applied the highest estimate to each unit in the Facility. This annual cost was allocated to the cost of generating the electricity across that year.

76. Synergy did not limit this calculation to the number of expected replacement parts required over the life of the generator, but rather applied this annual cost each year, regardless of whether the parts were in fact expected to be replaced before the end of the relevant generator's life.

77. Synergy did not adjust the cost based on the time value of money (or net present value) for maintenance expenditure which it expected to occur in the future.

(7) Fixed operating and maintenance costs

78. Synergy included annual routine maintenance or fixed operating and maintenance costs in its estimate of variable and operating costs used to calculate its start-up costs.

B. ISSUES

79. The following issues arise:

    (a) Issue 1: Did Synergy offer prices in its Balancing Submissions in excess of its reasonable expectation of the SRMC of generating the relevant electricity?

    (b) Issue 2: Did Synergy have market power?

    (c) Issue 3: Was Synergy's pricing behaviour related to market power?

C. CONTENTIONS

ISSUE 1: SYNERGY OFFERED PRICES IN ITS BALANCING SUBMISSIONS IN EXCESS OF ITS REASONABLE EXPECTATION OF THE SRMC OF GENERATING THE RELEVANT ELECTRICITY

80. Synergy's reasonable expectation of SRMC, for the purposes of clause 7A.2.17 of the Market Rules, is to be tested by what a reasonable Market Generator would have expected having regard to the circumstances known, and information available, to Synergy at the time of the Balancing Submission.

81. Synergy's SRMC is the cost for it to change production by very small amounts, or the first derivative of its total cost function, holding fixed the essential characteristics of the generation plant in question.

82. The input cost components that form part of Synergy's reasonable expectation of SRMC include fuel costs and start-up costs.

83. When generating units are bid in a portfolio, as was the case for Synergy, start-up costs are not a constant. Such costs change as the level of generation by the portfolio changes. Such costs may be classified as variable costs as they change with the level of generation. In the context of Synergy's Balancing Portfolio, start-up costs are appropriately included in Synergy's SRMC.

(1) Synergy offered prices in its Balancing Submissions during Period 1 that were in excess of its reasonable expectation of its SRMC

84. During Period 1, Synergy offered prices in its Balancing Submissions that exceeded its reasonable expectation of its SRMC of generating the relevant electricity in 2,030 out of the 2,664 Trading Intervals investigated.

85. Synergy's calculation of its SRMC during Period 1 exceeded Synergy's reasonable expectation of its SRMC due to the revised start-up costs not being consistent with Synergy's reasonable expectation of those costs.

86. Synergy's assumptions in relation to its start-up costs were unreasonable in the following circumstances:

(a) Synergy's estimate of its annual start-up cost based on its estimate of expected starts was not reconciled with the actual replacement of capital parts which would be required, resulting in an overestimation of Synergy's costs;

(b) Synergy overstated the number of expected starts for Facilities on the basis of applying the highest estimate of the number of starts for a particular generating unit to every generating unit in the Facility;

(c) Synergy's method allowed for the recovery for the cost of capital parts that would never be replaced, or were unlikely to be replaced given the remaining life of the Facility and so would not be a cost incurred by generator starts;

(d) Synergy included fixed operating and maintenance costs as part of its variable operating and maintenance costs including annual routine maintenance and inspection costs which are independent of the actual electricity generated and not appropriately included in a calculation of start-up costs;

(e) Synergy did not align capital parts replacement with plant inspections;

(f) Synergy did not adjust the costs to account for the time value of money when calculating costs over the life of a Facility.

(2) Synergy offered prices in its Balancing Submissions during Period 2 that were in excess of its reasonable expectation of the SRMC

87. During Period 2, Synergy offered prices in its Balancing Submissions that exceeded its reasonable expectation of its SRMC of generating the relevant electricity in 3,746 out of the 4,392 Trading Intervals investigated.

88. Synergy's calculation of its SRMC during Period 2 exceeded Synergy's reasonable expectation of its SRMC due to the revised start-up costs and gas input prices not being consistent with Synergy's reasonable expectation of those costs.

89. The increased start-up costs from Period 1 continued to be used by Synergy in Period 2 and increased the price offered in all of the relevant Balancing Submissions made by Synergy to a level above Synergy's reasonable expectation of its SRMC of generating the relevant electricity for the reasons identified in paragraphs 85 to 86 above.

90. During Period 2, Synergy's assumptions about its gas input price were unreasonable in the following circumstances:

(a) Synergy assumed that the future price of gas would rise, and continued to calculate the opportunity cost of gas based on the cost to store or swap gas rather than sell it on the spot market. That was unjustified, unsupported by forecasts and contrary to the information available to Synergy at the time (including the matters alleged at paragraphs 28 to 47);

(b) Synergy's use of the variable gas tranche price in the [redacted] Contract as the relevant future market price for Synergy's stored gas was unjustified, unsupported by forecasts and contrary to the information available to Synergy at the time (including the matters alleged at paragraphs 28 to 47);

(c) there were alternative, cheaper sources of gas available than the variable gas tranche price in the [redacted] Contract, and it was or should have been apparent to Synergy in advance that those sources would be cheaper;

(d) Synergy entered into new contracts to sell gas at prices significantly below the variable gas tranche price in the [redacted] Contract throughout the Investigation Period, which was inconsistent with the justification offered by Synergy for changing the way in which it calculated the opportunity cost of gas, namely that gas prices would rise in the future, making it more profitable to store or swap gas, rather than sell it;

(e) Synergy entered into new contracts to buy gas at prices significantly below the variable gas tranche price in the [redacted] Contract, which indicated that there were significant quantities of gas available for Synergy to purchase and that major gas sellers did not consider that the price of gas would rise significantly as this gas was available to purchase at lower prices.

91. During Period 2, the gas input price used by Synergy's was also unreasonable because it was based in part on unreasonable assumptions in relation to its industrial gas sales, and the price associated with those increased sales, as alleged in paragraphs 62(a) to (c).

92. Synergy's assumptions about its industrial gas sales were unreasonable in the following circumstances:

(a) there was no evidence and no appropriate forecast supporting increased gas sales or additional gas sale agreements that justified the increase;

(b) Synergy's actual sales at the time did not justify an increase and averaged [redacted] during Period 2;

(c) Synergy knew, or ought to have known, at the start of Period 2:

(i) that substantial gas supply contracts were about to expire;

(ii) what its contractual obligations were, and therefore what its unavoidable gas commitments were;

(d) any new industrial gas sales to meet increased demand for gas supply were discretionary, not unavoidable and therefore did not attract an opportunity cost of [redacted], being Synergy's claimed contract-break price;

(e) Synergy entered into new industrial gas sales contracts averaging [redacted] during Period 2;

(f) overall Synergy's total industrial gas sales fell during Period 2.

(3) Synergy offered prices in its Balancing Submissions during Period 3 that were in excess of its reasonable expectation of the SRMC

93. During Period 3, Synergy offered prices in its Balancing Submissions that exceeded its reasonable expectation of its SRMC of generating the relevant electricity in 7,132 out of the 7,756 Trading Intervals investigated.

94. Synergy's calculation of its SRMC during Period 3 exceeded Synergy's reasonable expectation of its SRMC due to the revised start-up costs and gas input prices not being consistent with Synergy's reasonable expectation of those costs.

95. The increased start-up costs from Period 1 and Period 2 continued to be used by Synergy in Period 3 and increased the price offered in all of the relevant Balancing Submissions made by Synergy to a level above Synergy's reasonable expectation of its SRMC of generating the relevant electricity for the reasons set out in paragraphs 85 to 86 above.

96. During Period 3, Synergy continued to base its gas input price on the opportunity cost of gas by reference to the value of the variable gas tranche price in the [redacted] Contract. This was unreasonable for the reasons identified in paragraph 90 and that it entered into a new gas supply agreement as described in paragraph 48.

97. During Period 3, Synergy's gas input price was also unreasonable because it was based in part on unreasonable assumptions in relation to its industrial gas sales, and the price associated with those increased sales, as alleged in paragraphs 65(a) to (c).

98. Synergy's assumptions in relation to its industrial gas sales were unreasonable in the following circumstances:

(a) there was no evidence or appropriate forecast supporting the assumptions;

(b) Synergy's actual sales at the time averaged [redacted] during Period 3;

(c) Synergy knew, or ought to have known, at the start of Period 3 what its contractual obligations were, and therefore what its unavoidable gas commitments were;

(d) any sales to meet increased demand for gas supply were discretionary, not unavoidable and therefore did not attract an opportunity cost of [redacted], being Synergy's claimed contract-break price;

(e) Synergy entered into new industrial gas sales contracts averaging [redacted] during Period 3;

(f) overall Synergy's total industrial gas sales fell during Period 3.

99. During Period 3, Synergy's gas input price was further inflated by an unreasonable storage assumptions of [redacted], and [redacted] in December 2016, being its expectation of injection at the Mondarra storage facility. The storage assumptions relied on by Synergy were unreasonable because at the start of Period 3, the Mondarra storage facility was nearly at full capacity with only [redacted] of storage capacity available and Synergy's storage assumption of [redacted] was unachievable.

ISSUE 2: SYNERGY HAD MARKET POWER DURING THE INVESTIGATION PERIOD

100. Synergy operated in the Balancing Market in the SWIS.

101. Synergy had market power during the Investigation Period. This market power is manifested by the following matters:

(a) Synergy was able to set the Balancing Price or materially influence the Balancing Price in the Balancing Market;

(b) the Balancing Market is concentrated and Synergy has significant market share;

(c) during Period 2 and Period 3, Synergy engaged in price discrimination between the industrial gas market and the Balancing Market.

(1) Synergy was able to set the Balancing Price or materially influence the Balancing Price in the Balancing Market

102. During the Investigation Period, Synergy set the Balancing Price for approximately 84% of Trading Intervals. Where Synergy did not set the Balancing Price in a Trading Interval, its Balancing Submissions materially influenced the Balancing Price as a consequence of the Balancing Portfolio accounting for a substantial share of the electricity cleared for dispatch in each Trading Interval.

103. A Market Participant without market power would not be able to overstate its SRMC and still be regularly dispatched. In a competitive market, if a Market Participant overstated its SRMC, it would increase the price offered in its Balancing Submissions and lower cost generators would be dispatched in preference.

104. Synergy set the Balancing Price for:

(a) approximately 76% of Trading Intervals investigated in Period 1;

(b) approximately 85% of Trading Intervals investigated in Period 2;

(c) approximately 92% of Trading Intervals investigated in Period 3.

(2) The Balancing Market is concentrated and Synergy has significant market share

105. The Balancing Market is a highly concentrated market. There are five Market Participants that generate approximately 94% of the electricity offered in the Balancing Market.

106. Synergy's market share is significant within the Balancing Market. In the 2016/17 Capacity Year, the Balancing Portfolio accounted for approximately 48.6% of total accredited generation capacity in the WEM. Synergy generated approximately 47.7% of the total dispatched energy in the WEM during the 2016 calendar year. While Synergy's market share can vary from day to day depending on outages and demand, Synergy's generation typically accounted for between 40% and 63% of the total dispatched energy on any given day during the Investigation Period.

(3) Synergy engaged in price discrimination during Period 2 and Period 3

107. Market discrimination is a profitable and possible strategy when the discriminating entity faces different price elasticities in different markets. This allows it to earn higher profits in markets where it can increase prices without losing commensurate demand and earning lower profits in markets where demand is more sensitive to price. To make price discrimination profitable, the discriminating entity must have market power in at least one of the relevant markets, as without market power it would be a price taker in each market and would not be able to discriminate.

108. Synergy engaged in price discrimination in Period 2 and Period 3 by applying a gas input price to determine the prices it offered in Balancing Submissions which was significantly above the price Synergy was selling gas for in the industrial gas market.

109. If Synergy did not have market power in the Balancing Market, the prices allocated as its gas input price would have been equivalent to the price it was selling gas in the industrial gas market.

ISSUE 3: SYNERGY'S PRICING BEHAVIOUR DURING THE INVESTIGATION PERIOD RELATED TO ITS MARKET POWER

110. Synergy's pricing behaviour (in offering prices in its Balancing Submissions during the Investigation that were in in excess of its reasonable expectation of its SRMC of generating the relevant electricity) was related to Synergy's market power in the Balancing Market.

Synergy's contravened clause 7A.2.17 of the Market Rules

111. In the premises, Synergy contravened clause 7A.2.17 of the Market Rules in respect of the prices offered in its Balancing Submissions for the 12,908 Trading Intervals during the Investigation Period.

DATED the 26th day of February 2020

[redacted]

Solicitors for the Applicant