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Government
of South Australia

Department of
State Development

Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Pierce

Thank you for the opportunity to provide comments on the options paper released by the Australian Energy Market Commission regarding the bidding in good faith rule change.

The aim of South Australia's Rule change proposal was to strengthen the current regulatory framework through providing greater clarity to generators and market participants regarding the meaning of bidding and rebidding in good faith to ensure generator bidding and rebidding practices are consistent with an efficient, competitive and reliable market.

As our initial proposal highlighted, we consider that the Federal Court decision during 2011 introduced uncertainty around the bidding in good faith provisions and raised issues in relation to the implementation of the policy intent.

We consider the Federal Court decision undermined the existing good faith provisions which seek to ensure that Market Participants are provided with accurate market information ahead of time, which is a fundamental element to the successful operation of the National Electricity Market. The Federal Court decision may provide a precedent for the future interpretation and operation of the bidding provisions.

While we thank the Commission for the further consideration and alternative options proposed in the options paper, we consider that the existing framework has been incorrectly characterised, which may have limited the Commission's consideration of options to address the issues.

As noted in section A.2 - History of the rebidding rules, rebidding was considered necessary to respond to physical conditions, including forced outages and for non-physical reasons, including reflecting participants' dynamic contractual positions and in response to rebids made by other participants, to ensure the efficient and effective operation of the market.

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The good faith bidding provisions were then incorporated in the National Electricity Rules to improve the reliability of pre-dispatch forecast prices and address aspects of generator's bidding and rebidding strategies that were of concern.

The provisions did this by requiring that rebids be made in good faith. As noted in section A2, a rebid is taken to be made in good faith if, at the time of making the rebid, the market participant has a genuine intention to honour that rebid if the material conditions and circumstances upon which the rebid was based remain unchanged until the relevant dispatch interval.

Contrary to this history, in the options paper the Commission has characterised the bidding and rebidding rules as requiring that generators submit bids to the Australian Energy Market Operator specifying the prices they are willing to receive for given amounts of generation volume offered. Following submission of initial bids, generators may submit rebids to shift the volumes they are willing to offer between these different price bands.

This starting point seems to suggest an unrestricted rebidding framework exists, rather than a framework that includes provisions regarding the appropriate market conduct for bidding and rebidding. It is important that the Commission's starting point for analysis acknowledges that the appropriate market conduct for rebidding existing in the National Electricity Rules today is for market participants to have a genuine intention to honour their bid or rebid if material conditions and circumstances remain unchanged.

In fact, Ministers have previously indicated that they are fundamentally opposed to generator bidding and rebidding strategies that were inconsistent with an efficient, competitive and reliable market, such as those not made in good faith, the blatant economic withdrawal of generation and the gaming of technical constraints.

In addition, Ministers included a \$1 million penalty for non-compliance with the bidding in good faith provisions to reflect their concern with this behaviour.

Appropriate rebidding behaviour

The Commission has indicated that they consider the specific behaviour that needs to be addressed is the submission of late rebids by generators where there is an intention to exploit the limited opportunity of other participants to respond. In relation to this behaviour, the Commission has noted that:

- 1) The previous bid or rebid may be submitted in the knowledge that it would or could never be honoured; or
- 2) The generator may have an intention to honour its bid or rebid at the time it was submitted.

Importantly, the current framework prohibits the first behaviour noted above.

The Department, however, considers the Federal Court decision has impacted the interpretation and consequently the ability for the Australian Energy Regulator to enforce the first behaviour noted above.

The Commission has proposed options for consideration in regard to rebidding behaviour, in particular has noted they include leaving the good faith provisions unchanged, removing the part of the good faith provisions that refers to a change in material conditions and circumstances and replacing the good faith provisions with another behavioural statement.

The Department does not consider the option of keeping the good faith provision unchanged to be a viable option. This would ignore the implication of the Federal Court decision and the uncertainty it has created. In particular, a key component of the Federal Court decision was not to consider extrinsic material, emphasising the desirability of persons being able to rely on the ordinary meaning of a clause. Accordingly, if the meaning of the good faith provisions is not clear in the National Electricity Rules, amendments are needed to provide clarity.

The Commission's options paper accepts that there are substantial benefits to be gained from market offers that reflect the intentions of a generator. However, the options paper discussed the difficulty in practice of inferring intention.

This discussion could be summarised as accepting that the purpose of having the good faith provisions is valid, but there is problems in their enforcement, which is essentially the premise of the South Australian rule change proposal. Accordingly, whilst keeping and improving the good faith provisions should be an option the Commission continues to assess, the option of leaving the provision unchanged should be dismissed.

The Department urges the Commission to seriously consider the mechanisms included in the rule change request which seek to address the inference issue. In particular modifications proposed included:

- A requirement for participants to provide accurate and complete data and information that substantiates that the dispatch offer, dispatch bid or rebid has complied with the good faith provisions, if requested to do so by the AER. This requirement supplements the AER's powers set out in section 28 of the National Electricity Law by ensuring the information provided to the AER used to assess compliance is complete and accurate and new information will not be relied upon to justify a rebid at a later time. As previously advised, it is not in the best interests of consumers for a participant to use reasons to justify its bidding and rebidding at a later date, for example during court proceedings, which were not provided to the AER during the investigation stage.
- Providing greater clarification on what sources and matters can be assessed to determine the intention of the participant. In particular, the amendment seeks to ensure that the AER can assess the intention of the generator or market participant by inference to all of the dispatch offers, bids and rebids made by that participant.

The second option of removing the reference to a change in material conditions and circumstances is also of concern.

Given the Commission accepts that a market participant should have an intention to honour its bid or rebid at the time it is made, if a market participant truly holds this intention it follows that some change must occur for a market participant to want to submit a rebid. Accordingly, it seems appropriate that the good faith rules refer to a change in circumstances.

Removing the reference to a change in material conditions and circumstances would continue to leave open the issue of the meaning of good faith and make it almost impossible to prove that any bid or rebid was not made in good faith. Rebids could be made for whatever reason a participant desired, with the accuracy and reliability of pre-dispatch information being reduced.

The South Australian rule change proposal sought to clarify the definition of material conditions and circumstances by providing that a participant may vary its bids in response to a significant and quantifiable change in price, demand or other data published by the Australian Energy Market Operator (AEMO) in respect of that trading interval, or change in other material circumstances. However, it has been argued in the material provided by the Commission that requiring justification of every rebid may not target the problem. An alternate solution suggested in the material was to modify this approach to only capture re-bids close to dispatch.

The Department therefore considers that the Commission should consider an option which requires rebids within a certain timeframe of dispatch to be made in good faith, where good faith is clearly defined in the rules as proposed by South Australia. This requirement could work in conjunction with a gate closure mechanism, for example:

- for a period market participants would have unrestricted rebidding (allowing price discovery);
- this would be followed by a period of rebidding in good faith (providing market participants with more certainty that rebids will be honoured if there is no significant and quantifiable change in material circumstances from the commencement of this period);
- finally, there would be gate closure (providing a period of certainty within which demand-side can respond).

In this option the Department considers the rules regarding the period of rebidding in good faith should provide greater clarification around when a bid or rebid would be considered to be made in good faith. It should require all existing material circumstances to be taken into account when a bid or rebid is made, and require participants to honour their bids or rebids if these material circumstances remain substantially unchanged. The objective should be to provide participants with greater confidence in relation to the reliability and accuracy of pre-dispatch forecasts.

The Department also has concerns with the third option, which was replacing the good faith provisions with another behavioural statement of conduct.

While the Commission has conveyed the intent of such a statement in the paper, it is difficult to assess the potential effectiveness of such a statement without reviewing the proposed wording. Nevertheless, it is unclear how completely redrafting a behavioural statement of conduct would produce a more favourable outcome

compared to amending the existing Rules that have been tested in the Federal Court, enabling its imperfections to be better understood and corrected.

Late Rebidding

As noted by the Commission, one of the Department's concerns has been participant's ability to rebid close to dispatch, which provides other participants with little or no time to respond. The options paper notes that this activity has increased in recent years in some parts of the market, in particular South Australian and Queensland.

The South Australian rule change proposal sought to address this issue by ensuring that participants are provided with timely and accurate information with which to make demand and supply side response decisions. This included a requirement for rebids to be made as soon as practicable after a change in material circumstances comes to a participant's attention.

The Department does consider that restricting bidding close to dispatch, as proposed by the Commission, would be one mechanism that helps to provide other participants with time to respond. However, as noted by the Commission there always has to be a last bid, which means that whilst such a mechanism ensures demand-side has sufficient time to respond, it will not overcome behavioural issues that cause inefficiencies. For example, it would not address a participant's ability to submit a bid aimed at providing false information about the participant's intentions just before gate closure.

Accordingly, there would be merit to retain the requirement of the rule change proposal to require a participant to rebid as soon as practicable after a change of circumstances comes to its attention in any period which requires rebids to be in good faith.

It is important to note that the requirement to rebid as soon as practicable is not intended to prohibit a participant from relying on a combination of circumstances to justify a significant and quantifiable change in material circumstances, as raised in the options paper. If a combination of circumstances is used to justify material circumstances, the intent of the rule change proposal is that the 'as soon as practicable' provision applies in relation to the occurrence of the last circumstance being relied on in the combination.

The options paper also notes that an issue with a gate closure mechanism may be that participants perceive different periods of time as reasonable. The Department considers this a valid point, however one which should not be insurmountable with further consideration and feedback from participants and the AER.

In regards to the specific options for the design of a gate closure mechanism, it is important that it does not prevent participants from rebidding where there is a genuine need to do so, for example for safety and technical issues.

Summary

In summary, the Department considers that the Commission should consider a combination of three approaches it has before it:

- 1) A period of unrestricted rebidding for price discovery;
- 2) Followed by a period of rebidding restricted by the requirement to behave in good faith, where the rules make it clear what behaviour constitutes good faith;
- 3) Followed by a gate closure mechanism, within which rebidding would be restricted to genuine need.

The Department considers this option would ensure:

- Efficient price discovery;
- Inefficiencies related to the intentions of the late rebidding generator are minimised; and
- Inefficiencies caused by late rebidding are minimised.

I thank you again for the opportunity to provide comment on the Commission's Options Paper. Should you have any questions in relation to this submission please contact me on (08) 8226 5500.

Yours sincerely



Vince Duffy

EXECUTIVE DIRECTOR

12 February 2015