



12 February 2015

Mr John Pierce  
Chairman  
Australian Energy Market Commission  
PO Box A2449  
SYDNEY SOUTH NSW 1235

Submitted Electronically: ERC0166

Dear Mr Pierce,

### **National Electricity Amendment (Bidding in good faith) Rule 2014**

Alinta Energy (**Alinta**) welcomes the opportunity to make a submission in response to the options paper prepared by the Australian Energy Market Commission (**AEMC**)'s on the proposed National Electricity Amendment (Bidding in good faith) Rule 2014 that was lodged by the South Australian Minister for Mineral Resources and Energy.

Alinta is an active investor in the energy retail, wholesale and generation markets across Australia. Alinta has around 2500 megawatts of generation capacity in Australia (and New Zealand) and a growing retail customer base of over 800,000.

Alinta actively trades in the National Energy Market (**NEM**), notably in the "spot market", and utilises rebidding for its generation fleet. The options presented by AEMC, if implemented, would mark a significant departure from the status quo and would directly impact on Alinta.

### **AEMC's Options Paper**

Alinta understands the purpose of the options paper produced by the AEMC is to discuss and present the outcomes of its assessment as to whether there is a problem associated with the existing good faith requirements in relation to rebidding. The options paper is also intended to seek the views of stakeholders on a number of alternative identified options to address the defined problems associated with rebidding.

The AEMC's options paper has identified a number of potential issues related to bidding behaviour of generators and the design of the bidding process. These findings include:

- Based on the work of ROAM and Oakley Greenwood rebidding and more specifically late rebidding appears to be a "*recent phenomenon, occurring within the last two years and predominately in Queensland*".
- Late rebidding behaviour has the potential to impair efficiency of the price discovery process by casting doubt on the reliability of information.
- Late rebidding has the potential to lead to higher priced generation to be dispatched over lower priced generation.

In light of the issues including some perceived inefficiencies created by late rebids, the AEMC is seeking comment on two wide-ranging approaches to potential reform around the existing rebidding requirements to improve market outcomes:

1. Amending the existing behavioural statement of conduct in the National Electricity Rules (NER), including potentially redefining what is meant by good faith, or limiting the circumstances in which a generator may rebid; and/or
2. Amending the basic design of the market to restrict rebidding close to dispatch through the implementation of an earlier gate closure mechanism.

Alinta notes that the AEMC has expressed the following views which are relevant when considering the identified options:

- Placing restrictions on rebidding close to dispatch may inadvertently cause inefficiency outcomes to arise. Nonetheless providing certainty in this way would mitigate the issue of non-responsiveness in the market.
- The AEMC concedes that if it is accepting rebidding as a problem, then by default any reform would require the consideration of several trade-offs which could lead towards more onerous conditions being placed on participants.

It is within this context that Alinta provides its views on the AEMC's options paper.

#### **Alinta's views on the options paper**

The AEMC's options paper and the associated work that has been undertaken to date provides a broad and detailed consideration as to whether there is in fact a material problem being created by late rebidding in the NEM. Based on the material presented by the AEMC, Alinta maintains its position that the impacts of rebidding on the market do not need to be addressed through either:

- Introducing a new behavioural statement of conduct; and/or
- Significantly amending the market design to introduce an earlier gate closure mechanism.

This is because:

- There is no evidence that rebidding represents a market failure in the NEM:
  - Instances of rebidding are infrequent, transient in nature and are limited to case by case scenarios often arising from a unique set of conditions in the market such as planned transmission outages being present; this is particularly relevant to the Queensland region.
  - There is no evidence that systemic rebidding exists or that existing good faith provisions are not consistently adhered to by market participants. This was highlighted throughout the attached ROAM analysis which concluded "*overall rebidding activity of generators has progressively decreased each year since 2007.*"<sup>1</sup>
- The market has overtime developed effectively and efficiently, independent of any regulatory or government body direction, to a stage where it is well equipped to deal with rebidding.

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<sup>1</sup> AEMC Options paper, National Electricity Amendment 2014, Pg 20

- There is no evidence presented within the options paper which would imply that the NEM is ill-equipped or constrained in any manner to deal with any negative by-products as a result of rebidding.
- The success of the natural evolution of the NEM to address any potential issues associated with late rebidding is evidenced by the existence of several hedging products which allow participants to flexibly manage their risk as they best see fit.
- The NEM is and should remain dynamic. An early gate closure will lead to an inability for the market to account for late changes in information, likely producing suboptimal production outcomes and introducing an inappropriate distinction between supply and demand side participants into the market design.
- The introduction of significant changes to the market design will potentially have associated costs to the market.

While Alinta considers that it remains appropriate that the NEM ensures that intentional misleading behaviour is captured, the existing materiality provisions arguably create a significant basis of contention under the rules. In particular, there are potential issues associated with a narrow interpretation of the reference to a change or material change conditions and circumstances including potentially requiring traders to second guess whether information would be considered to represent a change from the perspective of the Australian Energy Regulator (**AER**). There are also issues created by too broad an interpretation of the meaning of a “material” change.

Alinta subsequently supports the AEMC recommendation to remove the material change conditions of rebidding (option 2) in its entirety, as it would increase the simplicity of the existing provisions and remove the current issues associated with how to interpret whether a “change” has occurred, and whether such a change was indeed “material”. This would result in the maintenance of the important aspects of the current good faith bidding requirements, i.e. that bids need to be reflective of traders intentions and that generators need to have the physical ability to perform in accordance with their bids.

Alinta’s views on these matters are further enunciated in the following sections of this submission.

### ***There is no evidence that rebidding represents a market failure in the NEM***



**Key Consideration: To date no market failure that would necessitate regulatory intervention have been identified. Rebidding occurs infrequently in the NEM and is not having a material impact on the efficiency of market outcomes**

A well-recognised foundation of capably working markets such as the NEM is the ability for supply and demand to be dynamically balanced in response to changing conditions. In practice in the NEM this equates to an auction whereby the Australian Energy Market Operator’s (**AEMO**) dispatch engine equates generator’s offers of supply with regionalised market demand, this occurs every five minutes with market settlement being based on an average of the preceding six five minute periods. Rebidding by generators is allowed following the submission of initial bids, allowing volume to be shifted between price bands. This functionality exists to provide generators flexibility to adapt to shifting market conditions.

The AEMC’s options paper outlines a number of potential inefficiencies associated with rebidding. In essence the general contention is that rebidding means that pre-dispatch price outcomes are not certain and have the potential to be different to actual realised price outcomes, particularly due to the physical inability of some generators to respond, and that this represents an unsuitable or inefficient outcome. Alinta does not agree that any of the highlighted “inefficiencies” are material enough to warrant reform of the existing dispatch process, including rebidding.

In Alinta's experience instances of rebidding are infrequent, transient in nature and are limited to case by case scenarios often arising from a unique set of conditions in the market such as planned or unplanned transmission outages. Alinta's view is consistent with that conveyed by the AEMC's observation in the options paper that there appears little evidence of systemic rebidding or that existing good faith provisions are not consistently adhered to by market participants. In particular, the work undertaken by ROAM Consulting and Oakley Greenwood suggests that the more widespread occurrence of late rebidding, and rebidding towards the end of the trading intervals, has been a recent phenomenon, occurring within the last two years and predominantly in Queensland. Additionally, as outlined in the options paper, rebidding occurs primarily as a result of several unique factors specific to the Queensland regional market including; high demand, low import head room and transmission constraints binding (predominantly the 871/855 constraint).

As such, Alinta would encourage the AEMC to reconsider the nature of the rebidding "problem" and whether it is great enough to warrant substantial change to NEM wide-market arrangements. It may now be the case that rebidding in itself is only the market responding to the unique structural conditions which exist within individual NEM regions, i.e. Queensland. If this were the case then constraining the ability for all NEM market participants to rebid would appear a heavy-handed response to a perceived problem that has not to date been effectively proven to be of material consequence to the market and would likely lead to unintended consequences and costs, which would ultimately flow back to consumers for little to no corresponding benefit.

Alinta notes the concerns expressed within the options paper that the existing rules place a substantial burden of proof on the AER being able to secure a conviction, and that this may have in part played a role in the failure of the AER's 2011 Federal Court case against the Stanwell Corporation. In Alinta's view one failed Federal Court action should not be the basis of a rule change proposal. Some of the proposals outlined within the options paper, if enacted, would have the direct effect of lowering the threshold to establish a case against market participants in the NEM or would dramatically increase the compliance obligations of market participants. Throughout the consultation process thus far, there has been no objective evidence presented which would indicate that rebidding represents a material issue which would justify reforms to the existing good faith provisions.

Whilst not perfect, the NEM is a well-functioning market which has a robust dispatch and bidding process. Despite careful consideration of the issue of rebidding by regulatory authorities, no evidence has been presented throughout the consultation period which would imply that rebidding is a significant problem, or is indeed systemic. As such, Alinta does not consider the case for a rule change has been made as no material inefficiencies are being created by late rebidding.

### ***The NEM is already well equipped to deal with rebidding***



**Key Consideration: In the absence of a clearly defined market failure, industry should continue to aid the further development and refinement of the existing mechanisms for managing the impacts of late rebidding.**

The NEM is designed to experience high prices at select times, signalling additional supply to come online. Where the entry of additional generation occurs in response to individual price events, select participants are responding in real time to the market conditions to defend their commercial position in the market. Where such entry does not occur, it may be that:

- the costs associated with entry would not validate the low level of scarcity rent on offer, inferring that participants have other hedging arrangements at their disposal; or
- level of scarcity rents available in the market are in fact not excessive.

In addition to the real time participation in the market, several hedging products have evolved within the NEM over time which allow participants to flexibly manage their risk as they best see fit. These arrangements are undertaken within derivatives and futures markets where products such as caps and swaps are traded. If late rebidding represents a material problem for market participants, a range of market based options are accessible for participants.

For example if a generator does not have the physical characteristics to respond quickly to individual high priced wholesale events which could be caused by a range of factors including rebidding, they may choose to take out a cap product which supplements their hedging strategy as best suits the management of their portfolio. Additionally, if late strategic rebidding was in fact prevalent in the market and subsequently caused participants concern then there would likely be sufficient historical precedence to allow market participants to pre-empt this rebidding behaviour and develop appropriate responses to adjust their exposure ahead of any anticipated price spikes. Nonetheless, there is no evidence presented within the options paper which would imply that the NEM is presently ill-equipped or constrained in any manner to deal with any negative by-products as a result of rebidding.

Given the above, Alinta does not support the range of options presented by the AEMC, particularly with respect to the introduction of earlier gate closure provisions or a new behavioural statement, as they would:

- Introduce unnecessary complexity into the market design which will make participants trading operations more complex – particularly given there is no evidence of market failure and the vast majority of market participants have not raised rebidding as a material problem to date.
- Create inefficiencies through attempting to regulate the trade-off between ensuring that prices reflect market conditions and the ability of market participants to influence price outcomes. That is, enabling market participants to manage this risk through the continual evolution of hedging products is the more efficient approach as the market will be more nimble in responding to any future changes than a relatively blunt regulatory instrument.
- Remove the current incentives provided by the market for investment in generation and DSM that can respond relatively quickly to changes in market conditions. Other markets have identified that “fast response” capacity is particularly valuable from a system security and reliability perspective given the increased penetration of intermittent generation<sup>2</sup>.
- Place an onerous compliance burden on participants, particularly with respect to the “*rebids permitted with additional reporting requirements*” option presented by the AEMC which would enable rebidding after gate closure but require supplementary compliance and reporting requirements.
- Reduce the effectiveness of the NEM’s existing price discovery mechanism, despite existing participants placing significant weight on the importance of this feature of the NEM’s design. This issue is explored further in the next section.

It is Alinta’s view the broad ranging reform options presented in the options paper don’t appropriately consider the value of existing risk mitigation tools currently available in the market which have proven over time to be effective. Alinta contends that to the degree that rebidding represents a problem to the market, the market is best equipped to respond in the most timely and cost effective way. The absence of an identifiable market failure creates little basis to continue advancing any major changes to the market design such as the introduction of earlier gate closure provisions or a new behavioural statement.

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<sup>2</sup> Alinta notes that these concerns have driven the consideration of apportioned capacity markets in other jurisdictions.

### ***The NEM is and should remain dynamic***



**Key Consideration: All generation capacity should be treated equally under the market design, unless a clear reason for differential treatment can be established. The introduction of earlier gate closure provisions in the NEM would introduce an inappropriate differentiation between demand and supply side resources**

The NEM is a dynamic and well-functioning market which has overtime delivered competitively priced energy to a high system security and reliability standard. The NEM's ability to deliver these outcomes is based on the capability of both the supply and demand side of the NEM to adjust in response to the continually changing metrics.

As noted above, Alinta does not support the implementation of earlier gate closure provision into the NEM's basic design, as a pre-condition to the NEM being an efficient market is that it enables participants to liberally respond to dynamic market conditions. This price discovery feature of the NEM's design is strongly supported by the vast majority of market participants. It is also arguable that it would be inconsistent with the National Electricity Objective to limit the efficiency of the market's price discovery mechanism by fixing the supply of electricity at a certain point in time, so as to enable demand side response greater certainty of the price and therefore an enhanced ability to respond to market conditions.

Alinta considers it worthwhile dispelling the notion that imposing a late gate closure on bids (and thus preventing rebidding +/-5 minutes before dispatch) will produce improved market outcomes. Whilst fixing the supply component may produce greater certainty for demand side management, the ACCC previously rejected an early gate closure approach citing an inability for the market to account for late changes in information, as it considered that it would likely produce suboptimal production outcomes.

Additionally from an equity perspective, it appears inappropriate to limit the supply side of the market from responding to changing market conditions, if there is no corresponding restriction on the demand side of the market. It is Alinta's view that the market already contains several information asymmetries which result in wealth transfers between participants, for example the impact of aggregated non-scheduled, non-market generation plant in South Australia has been shown to deliver distortive outcomes underpinned by inequitable treatment under the rules<sup>3</sup>. Arguably the impact of non-scheduled generation creates a greater inefficiency in the market than rebidding ever could, given non-scheduled generation does not appear in pre-dispatch, yet whilst this issue has been well identified it still remains unresolved.

In Alinta's view the options presented within the options paper which consider enhanced disclosure obligations cannot be considered in isolation. Early gate closures or prescriptive information disclosure requests must apply equally under the rules to both the demand and supply side of the NEM, or run the risk of creating further market distortions and inefficiencies.

### ***Significant market design changes will have associated costs***



**Key Consideration: An earlier gate closure within the NEM may have the unintended consequence of imposing additional costs on the market, including via increased ancillary service requirements.**

Whilst all energy markets are different, at the time of the NEM's design the late gate closure time was cited as a market leading approach. Given this, the imposition of early gate closure as discussed in the options paper would appear a regressive step in market reform and would likely raise ancillary service requirements, increasing costs and other productive inefficiencies. By way of example, the

<sup>3</sup> Australian Energy Regulator, Special Report "Market outcomes in South Australia during April and May 2013", July 2013.

Western Australian Energy Market (WEM) is roughly one tenth the size of the NEM in terms of demand and significantly smaller in terms of transmission line span. Nonetheless the WEM's load following ancillary service (LFAS) requirements are almost half of those required in the NEM.

When recently investigating the reasoning behind such relatively high LFAS requirements, System Management, the network system operator of the WEM, cited long gate closure times as the primary reason. This is because in the WEM, gate closure is 2 hours in advance of dispatch which means that ancillary services have to be procured based on expectations of market outcomes 2 hours in advance of real time (as opposed to similar requirements being determined 5 minutes in advance in the NEM). The corresponding result is a dramatic effect on the volume of LFAS procured by System Management for the WEM.

This was apparent in System Managements recent submission to a review of wholesale arrangements in the WEM which concluded that:

*“System Management believes that a move to a shorter gate closure and dispatch cycle times would have a dramatic effect on required LFAS Volumes. As a result of a marked reduction in volume, there would naturally be an increase in competitive pressure...”<sup>4</sup>*

Given the above, in Alinta's view it remains highly likely that a move to impose an earlier gate closure time within the NEM may have implications for ancillary service requirements that would need to be better understood by the market. As such, Alinta would urge greater consideration of the unintended consequences that imposing an early gate closure may have on the NEM, including ancillary service requirements, as introducing an earlier gate closure time will likely impose real secondary impact costs on the market.

### Rebidding in response to changes/material changes in AEMO data



**Key Consideration: In competitive and mature market such as the NEM, participants should be allowed to price their generation as best they see fit. The AEMC should consider the removal of the materiality conditions for rebidding altogether.**

Under the NER, all generators submit bids and rebids in “good faith” where it is deemed to be in good faith if the generator has a genuine intention of honouring their offer of supply to the market at that time if the conditions and circumstances upon which the decision to submit the bid remains unchanged.

Nonetheless, if the market conditions or circumstances on which that bid were made change, generators are permitted to submit a rebid. Clause 3.8.22A requires participants to submit a brief, verifiable and specific reason to AEMO at the time of submitting a rebid and this reason is publicly viewable within AEMO pre and post-dispatch engines. These reasons are categorised into four distinct categories:

1. The technical considerations of the generator have changed;
2. There has been a material change in AEMO data or forecasts;
3. A bid has been submitted in error; and
4. Rebids have been changed on a financial basis.

<sup>4</sup> System Management Submission to the Economic Regulation Authority of Western Australia, 12 January 2015, Discussion Paper 2014 Wholesale Electricity Market Report to the Minister for Energy, pg 2.

Alinta understands that the proponent and regulatory bodies such as the AER hold some concerns over the degree of ambiguity around the definition of whether a “change” or “material” change in AEMO data or forecasts has in fact occurred. As outlined in Alinta’s previous submission a wide interpretation of the term material is to a degree problematic as in practise it may lead to all information being termed as material and thus justify all rebids based on what individual market participants deem material.

In the same vein, a narrow interpretation of materiality is also problematic as minute changes in market prices can have the effect of evoking bilateral contracts. For example, a small change in wholesale prices from \$95/MWh to \$100/MWh could be the strike price trigger for a cap or swap contract, meaning that the market conditions of that particular participant’s portfolio have materially changed, whilst the broader market conditions may have only changed minutely. As such, a narrow interpretation of materiality could lead to participants second guessing themselves when market conditions change; would a trader enter a rebid if they think that regulatory bodies will infer a bid has been made not in good faith?

Other considerations associated with the issue of materiality have been well debated in past settings as well as the current options paper, and yet remain unresolved or untested in a legal context. These include:

- If requirements are introduced for participants to vary their bids only in response to significant and quantifiable changes in price demand or other data this would require a regulator to hold a subjective view on what defines a “material change”. This in itself is problematic.
- In effect, a reverse onus of proof will be established whereby trader’s bids will be inferred to not be in good faith unless the market participant proves otherwise. This would have the effect of raising compliance and regulatory costs for participants.
- If participants can only vary bids based on “significant changes” in market conditions traders will become reluctant to rebid at all, in effect requiring generators to commit to a prearranged amount of supply several intervals away from dispatch, locking in operational and fuel costs for that unit. This represents a restrictive and unproductive outcome for both participants and market.
- Restrictive conditions being placed on rebids will diminish the rents available to flexible fast start plant in the market; this would have a longer term secondary impact effect of undermining investment incentives for fast start plant.

Given the issues outlined above, it is Alinta’s view that in a mature and devolved energy market such as the NEM participants should be able to price their generation, including at times of scarcity, as they best see fit. Given the highly competitive and dynamic nature of the NEM, the low instances of rebidding, the maturity and availability of market based hedge products, the substantial regulatory oversight of market competition and the fact that rebidding does not represent a market failure, there seems little logic in retaining the existing restrictive conditions that are placed on participants.

As such Alinta proposes that the AEMC should consider the removal of any reference to a change in AEMO data as a reason for rebidding. This would remove the recognised concern where AEMO data is fed into participants private analytical and forecast models, producing results based on individual participants commercial positions. This in practise leads to participants referencing AEMO data as a reason for rebidding, triggering debate over where a “change” or indeed a “material change” in market conditions has in fact arisen.

To conclude, Alinta would be supportive of the AEMC considering removal of the “change in material conditions” of rebidding in its entirety (option2), and would be content with a practise where rebids

are only made based on the technical considerations of the generator, bids submitted in error and rebidding on a financial basis.

### **Conclusion**

Alinta maintains its position that the impacts of rebidding on the market do not need to be addressed through either:

- Introducing a new behavioural statement of conduct; and/or
- Significantly amending to the market design to introduce an earlier gate closure mechanism.

As outlined above, the NEM is a well-functioning market which has a robust dispatch and bidding process. As such it is not surprising over the NEM's history there has been no evidence of systemic instances of rebidding or in fact, any case where a rebid has been made contrary to good faith. To the extent that late rebidding is perceived by participants to be a problem, the NEM is well equipped with market based hedge products to deal with any resulting impediments caused.

Alinta would urge greater consideration of unanticipated regulatory, compliance and ancillary costs which will likely be realised if earlier gate closure provisions were introduced. Such costs create inefficient prices which are ultimately passed on to consumers.

More broadly, Alinta considers that the existing provisions may restrict efficient outcomes occurring in the market and so supports the AEMC removing the change in conditions provisions of rebidding (option 2).

Should you have any queries in relation to this submission, please do not hesitate to contact Mr Anders Sangkuhl on, telephone, (02) 9375 0962.

Yours sincerely,



**Michelle Shepherd**

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