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Dear Commissioners

Lodged electronically: www.aemc.gov.au (ERC0166)

AEMC 2015, Bidding in Good Faith, Rule Determination, 17 September 2015, Sydney

EnergyAustralia welcomes the opportunity to make a submission on the 'bidding in good faith' second draft rule determination (the second draft rule).

We are one of Australia's largest energy companies with over 2.5 million electricity and gas accounts in NSW, Victoria, Queensland, South Australia, and the Australian Capital Territory. We also own and operate a multi-billion dollar portfolio of energy generation and storage facilities across Australia, including coal, gas, and wind assets with control of over 4,500MW of generation in the National Electricity Market.

There is no doubt that a generator must not make bids that are intended to be false or misleading, and must not delay the time at which they make rebids in order to prevent other market participants from responding. In this respect, we agree with the general aims of the rule change.

However, the second draft of the proposed rule is a more radical step beyond both the current rule as well as the first draft rule. We are still not convinced that such a substantial redrafting is required to address the perceived issues and we are still not clear what a participant, who currently bids 'in good faith', should do differently in response to the changes.

If a change to the rule is to be made, it must capture the behaviour of generators who set out to manipulate market outcomes yet not cause significant adverse impacts to generators who make timely bids in good faith. We consider that the second draft rule improves the ease of prosecution at the expense of the efficient operation of the market. A well-considered cost-benefit analysis may show that the National Electricity Objective is not satisfied by the proposed rule.

In addition, there are elements of the second draft rule that are either not clear or have (apparently) unintended consequences that create a significantly more uncertain bidding environment for generators. Generators attempting to make reliable bids that do not mislead could be found to have contravened the rules. The fact that generators will not have any great certainty if their rebids are legal or not at the time the rebid is made is a major problem. This alone will impede efficient outcomes by creating a disincentive for generators to rebid.

Although, pleasingly, the additional burden to submit all late rebid reports to the AER has been removed, the second draft rule still requires contemporaneous records to be captured. This will create additional costs and directly impact our operations by temporarily removing traders from watching and analysing the market during periods of high prices when the optimisation of dispatch offers is integral to risk management. All options to reduce the negative effect of the proposed reporting obligations should be examined.

One particular issue that arises under the proposed rule is that the rigid structure of the bidding system and dispatch process cannot accommodate all technical plant limitations. This can prohibit the generator accurately reflecting their true intentions in a dispatch offer or rebid, and these offers and rebids would be at risk of being found false and misleading.

We elaborate on this and other areas of concern in our submission. There are various possible solutions which capture the targeted behaviour without constraining efficient rebidding and that allow for practical and operational issues that commonly occur in the market.

If you any have questions on our submission please contact me on (03) 8628 1242 or at melinda.green@energyaustralia.com.au.

Regards

Melinda Green
Industry Regulation Leader
EnergyAustralia

1. The case for change

Cost-benefit analysis

The Commission needs to define a benefit calculated as the real avoided costs and real benefits. It is not valid to directly compare overstated, potential market distortions with real economic costs to the industry. For the rule to have a net benefit, the Commission must identify current behaviour - either allowed or otherwise unenforceable - which will be prevented under the proposed rules. We request that the Commission quantify the costs and benefits based on regulatory best practice guidelines before a change is made.

The Commission has not identified any specific, historic rebids which may have been different under the proposed rule. The Ernst & Young study *Impact of late rebidding on the contract market* captures an array of efficient rebids as contributing to a market distortion. The major limitations of the study (as outlined in the study itself), is that it does not distinguish between correlation and causation and conflates the market failure with all genuine late rebids. The overwhelming majority of late rebids are necessary for the market to function efficiently.

Furthermore, the study only attempts to quantify the effect of 5/30 (the mismatch of 5-minute dispatch and 30-min settlement) due to late rebids, not the effect of late rebids themselves. The benefits claimed could potentially be captured through alignment of settlement and dispatch periods but distortions resulting from 5/30 are not something that the current rule will address.

Minimise regulatory changes

The new rules appear to have been based on outcomes of legal proceedings rather than determining the best way for issues to be addressed while minimising impacts to the operation of the market. The ability to take enforcement action is important to regulating participants' actions, but should not be the only basis for a rule. Ineffectual enforcement action has not allowed a flood of inefficient and illegitimate rebidding.

We believe the proposed rule change will not give greater certainty of price to enable improved short-term optimisation of generation/demand position or long-term investment certainty. Contributions to price uncertainty and volatility come mainly from inaccuracies in pre-dispatch demand and constraint forecasts and the lack of non-scheduled generation forecasts.

Distributed generation, battery storage, and other new technologies are increasing in output as traditional, centralised generation is reducing. Currently there is an asymmetry in the market information provided by scheduled generation and what is provided by non-scheduled generation and demand response. There are only marginal gains in improving the veracity of market information through regulation on scheduled generation.

The issue identified is that rebids are being delayed unreasonably from when the intention to rebid has been formed. Good regulatory practice is that the minimum changes to the rules required to enact the change should be made. Rather than a substantial redrafting, we suggest that smaller amendments to the current rule will be more successful. For example, the explicit inclusion of a requirement to rebid as soon as reasonably practicable will produce a corresponding change to bidding behaviour and is a proportionate response to the issue.

2. The change to 'false and misleading'

Seismic shift to a strict liability regime

We are concerned with the changes proposed in the second draft rule to insert two 'deeming 'provisions, 3.8.22A(a1) and 3.8.22A(b),[1] and their meaning. We are especially concerned that it takes the limitation on the market beyond the current state of the law, as set out in 3.8.22A(a), so that the intention of the generator is no longer relevant. The second draft rule creates the risk of a court finding a strict liability obligation is created by the combination of proposed clauses 3.8.22A(a) and 3.8.22A(a1).

Under such a strict liability interpretation, a generator would be in breach if the deemed representation in 3.8.22A(a1) was not met, regardless of the intention of the generator or other mitigating circumstances. This would significantly broaden the clause because a rebid could breach the rule even if the generator had a genuine intention to honour that rebid and a reasonable basis for making the deemed representation.

Is it the Commission's aim to create a strict liability civil penalty offence that does not require any reference to clause 3.8.22A(b)? If so, we see this as a seismic shift out of all proportion to the materiality of the issue. Significant penalties for individuals and companies apply to this section of the NER and therefore the ramifications of the proposed change will be significant increase in risk for all our trading activities.

Given the risk that extrinsic materials may not be referenced by a court regarding the interpretation of any such promulgated rule, a risk mentioned in the SA Ministers proposal,[2] we recommend the Commission at least redraft the proposed rule to remove the strict liability obligation and ensure that contraventions are assessed against clause 3.8.22A(b).

However, as outlined earlier, we prefer that the Commission retains the current good faith provisions but includes a clause explicitly requiring rebids to be made as soon as reasonably practicable after an event. This change targets the behaviour in question while making the obligations on generators clear.

Deeming an offer or rebid to be misleading

Proposed clause 3.8.22A(b) provides two avenues by which a generator may be prosecuted for a breach of 3.8.22A(a) by virtue of the behaviour being deemed to be false or misleading in either of the two circumstances. Assessing the second limb (b)(2), we understand courts have interpreted 'reasonable basis' for making a representation as requiring the person to have both an intention and ability to perform the representation. Clearly, in the case of bidding, a generator will always have the ability to represent that they will not change their offer or rebid. The interpretation of the second limb from a legal standpoint therefore seems to be identical to the first limb.

Accordingly, we request that the Commission clarify the conduct to which the two limbs is intended to apply and why this conduct cannot be captured adequately when there is an 'and' between (b)(1) and (b)(2).

The requirement to have a 'continuing representation'

In the second draft rule determination, the Commission refers a number of times to the situation in which a generator's current offer becomes misleading between the point that a

[1] All clauses referenced in this document are from the current National Electricity Rules (NER) or the Second Draft Rule.
[2] The Hon. Tom Koutsantonis MP, Minister for Mineral Resources and Energy SA rule change request, 13 Nov 2013

participant has a change of intentions (based on a change in market conditions), and the point that the rebid is made.[3] This has been referred to as a 'continuing representation'.[4]

It's obviously impossible for a rebid to be made at exactly the same instant as the change in intention occurred, so there will always be a small period where the current offer could be seen to be misleading. We understand the Commission's desire to ensure this period is as short as possible; this is the intent of clause 3.8.22A(d). On the other hand, clauses 3.8.22A(a), (a1) and (b) attempt to establish the nature of the representation that a generator makes to the market by making an offer or rebid; and when this representation can be considered false and misleading.

The overall intent of clauses 3.8.22A(a), (a1), (b) and (d) seem sufficient in isolation without having to determine that the original offer was false and misleading for a short period of time. It's unclear why the Commission believes this is an important implication of the rules and how it might be relied on in practice.

Physical limitations and inadvertent contraventions

The proposed drafting has the potential to capture generator bids where every intention has been made to comply with the rules. Yet the rigid structure of the bidding system and dispatch process means that a generator's true intentions cannot always be accurately represented in a dispatch offer or rebid. This is especially true for fast-start plant which must self-commit aggregated units and other plant with physical limitations unable to be signalled to the market though the bid structure.

One example is peaking generation which intends to run at a price, say $300, and which could reasonably be expected to bid its generation in at this price. However in reality for a generator to run at these prices it must receive dispatch instructions before the event to ensure it is online for the high-price period. This is due to unit start up time and the corresponding Fast Start Inflexibility Profile submitted to AEMO. This functional work-around requires a 'late' rebid with a price very different from the original dispatch offer and potentially where a material change in circumstances may not have occurred.

This is a common example and one for which a generator would likely not be prosecuted. However, it highlights the issues with representing to the market that bids will not be changed without a material change in circumstances. Further situations will arise from bidding generation as one aggregated unit. This includes the inability to represent that some individual units are offline which are unable to meet dispatch targets.

It is necessary to address these issues by either reducing the likelihood that other participants are misled or by better aligning the dispatch process to account for physical limitations. We suggest a number of approaches:

- A variation to proposed clause 3.8.22A(a1) which allows for more flexibility in what a dispatch offer is deemed to represent to the market;
- A guideline prepared by the AER to instruct market participants in the limitations of specific generating units and how dispatch offers should be interpreted;
- The creation of a new type of market participant who would operate under a lighter form of the bidding and dispatch process to maximise the usefulness of information provided for forecasts and enable smaller generators to be captured; and
- A variation to the generation registration format allowing the distinction between online and offline capacity.

[3] AEMC, Second Draft Rule Determination, 17 Sep 2015, pages, 9, 33, 44

[4] AEMC, Public Forum Session 1, Bidding in Good Faith Draft Determination presentation, Cathy Philipp and Sebastien Henry, 18 May 2015, page 7

We are concerned that the proposed rule will capture a variety of other scenarios where traders have no intention to make a false or misleading offer including:

- Times of high prices where decision making could involve more than one person where that other person may not have been involved in making the previous dispatch offer;
- Where bids submitted for a generating unit that becomes unstable cannot usefully and accurately updated to reflect the plant's capability through rebids until the plant has regained stability; and
- An offer or rebid where a genuine error has occurred.

Reasonably practicable

Changes from the first draft to the second draft included the removal of 'reasonable' from clauses 3.8.22A(d) and 3.8.22A(e) resulting in the requirement to rebid 'as soon as practicable'. The drafting of the rule should reflect that reasonable circumstances are a legitimate reason for a rebid submission beyond a purely practicable timeframe. Meeting a 'practicable' timeframe could require excessive investment or other disproportionate actions that would not be required if the clause required rebids to be made 'as soon as reasonably practicable'.

We foresee situations where generators responding to other participant's rebids or market changes will be affected by the uncertainty in the allowable time to make a rebid. One generator may rebid in response to a market change by re-pricing generation causing an unexpectedly high price or low price. It is the responder, who does not make a rebid in the first instance, who has uncertainty in what constitutes legal behaviour as some time has passed since the event. We believe that a 'reasonably practicable' timeframe is appropriate to ensure efficient responses to market changes, and therefore that the term 'reasonably practicable' should be retained in clauses 3.8.22A(d) and 3.8.22A(e).

Reference to pre-dispatch schedules

We seek further clarification on clause 3.8.22A(a1) and why it is necessary to deem that a representation is made to other market participants "*through the pre-dispatch schedules published by AEMO"*. The pre-dispatch schedule is defined in clause 3.8.20 and references trading intervals only. It does not account for the 5-minute resolution pre-dispatch published for each dispatch period. The period covered by the *pre-dispatch schedules* does not include the current or next trading interval and as such a representation is not deemed to have been made in this period.

If there is no particular purpose to the phrase "*through the pre-dispatch schedules published by AEMO"* in clause 3.8.22A(a1), then we request it be removed.

3. Contemporaneous records

Reporting obligations

The compliance costs relating to the information recording obligations are a significant concern although we acknowledge the improvement of the second draft rule over the first with respect to reports only being provided to the AER only on request.

Our main concerns with contemporaneous record keeping are:

- A trader who is making a contemporaneous record is not watching the market or optimising generation as late rebids often occur in volatile periods with uncertain market conditions. The cost of compliance has not accounted for the opportunity cost of traders having less time to assess market conditions, make decisions and submit rebids.
- Due to time constraints, contemporaneous records may be taken down hurriedly which could impact the accuracy and completeness of the information. Limiting the information required will enable participants to produce better quality records and reduce compliance costs of participants.

The most important consideration for the Commission is that the proposed rule should not deter or otherwise hamper legitimate rebids in response to changing market conditions. A record relating to one particular rebid is not excessive; however given the volume of rebidding activity undertaken by market participants, all efforts to narrow the scope of the reporting obligations will assist in greatly reduce compliance costs.

Reports available to participants

The information recorded contemporaneously must be supplied to the AER on request to substantiate and verify rebid reasons under clause 3.8.22(d). Given the weight the court may give to patterns of behaviour, information requested by the AER could relate to an extensive selection of rebids. These records are then available to market participants on request with exceptions for confidential information.

Given the possibility of disagreement as to what constitutes confidential information, competitor access to this data is an unnecessary consideration that traders must be conscious of when making records. It is not clear how market participants benefit from more detailed explanations for rebids except to gain an understanding of strategy and position of the generator which is inappropriate in a competitive market. This does not benefit the market or consumers and as such we recommend that sensitive information (such as recorded under 3.8.22(ca)(ii)), is always designated as confidential information.

Targeted record keeping

A reduction in reporting obligations could allow all reports to be provided to the AER as a matter of course. This would greatly improve the quality of reports created by the AER under clause 3.13.7(d) of the NER for half-hourly spot prices above $5000. A late rebidding period of 10 minutes before a dispatch interval with a 5-minute dispatch price exceeding $5000 will allow a trader to make a contemporaneous record while the reasons are still front of mind. A guideline outlining the details in the report could allow for more detailed and targeted reporting in times which have a greater ability to affect the market negatively.

We encourage the Commission to also consider reducing the timeframe of the late rebidding period from 15 minutes to 10 minutes. This will still ensure all rebids are included in a 5-minute pre-dispatch forecast before the relevant dispatch period becomes active. The majority of high price periods last no longer than 5 minutes which demonstrates that the market can respond effectively in the suggested timeframe.

4. Conclusion

In summary, we feel that the second draft rule is not an improvement on the first draft rule as the changes are substantial compared to the current NER and will have a detrimental impact on market efficiency. We would like to see the case for change established through a thorough cost-benefit analysis and that any changes to the rules are clear and only made to the extent required to address the issues.

Unnecessary change and confusion has been introduced in the second draft rule and we are most concerned with the following aspects of the second draft rule:

- The lack of justification to move away from the current approach of 'good faith intention';
- Clauses 3.8.22A(a) and 3.8.22A(a1) possibly place a strict liability obligation on generators. It is unreasonable not to assess possible breaches of these clauses against clause 3.8.22A(b);
- The drafting of clause 3.8.22A(b) around how an offer or rebid is deemed to be misleading has two limbs that are not distinct and therefore we believe the word 'and' should be retained; and
- The removal of the word 'reasonably' in clauses 3.8.22A(d) and 3.8.22A(e) implies that a generator may have to incur excessive costs in order to carry out an action as soon as operationally possible. We recommend the Commission to retain the term 'reasonably practicable' in these clauses.

The proposed draft rule creates operational difficulties and introduces additional risk for generators, particularly in periods of intense late rebidding and where plant limitations exist. Generators must have more certainty on how the rules will be applied in practice. Given these issues we would not like to see this rule change made final without significant amendment to minimise the change from the current rules. Sections 3.8.22 and 3.8.22A of the NER underpin the entire National Electricity Market dispatch process and it is critical that any changes made are the right changes and meet the National Electricity Objective.

As currently drafted, it is difficult to estimate an appropriate date for the proposed rule changes to become effective. If the second draft rule becomes final, we would consider the need for an additional rule change on the classification of generation and this could take some time to complete. However, if our concerns regarding plant limitations are addressed in the final rule then we suggest a reasonable timeframe would be one year from publication of the final rule to allow for re-training and the development of reporting systems.