



Major Energy Users Inc.

Australian Energy Markets Commission

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Comments on the Options Paper

Submission by

The Major Energy Users Inc

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of the MEU and its consultants.**

The Major Energy Users Inc (MEU) welcomes the opportunity to provide comments on the AEMC's Options Paper issued as part of its assessment of the rule change proposed by the SA government to address the observed use by generators of rebidding as a tool for increasing their revenue when market conditions do not warrant such an increase in revenue. The SA Government rule change proposal is strongly supported.

The MEU has seen that generators are using their market power to increase their revenue when they know they are in a position where they must be dispatched at any price in order to maintain system reliability. This was the focus of the 2011 MEU proposed rule change and the MEU sees that its proposed rule change, the AER proposed rule change on ramp rates and the SA government proposed rule change on rebidding are all related to the exercise of generator market power.

The Options Paper makes some very pertinent observations about how generators can and will use the market rules to maximise their profitability, including the use of rebidding of offers to the market. The MEU also notes that there is a need for rebidding as this provides the ability of the market to provide the most efficient outcome for consumers as circumstances change. In a perfect market, all rebids would be made by generators and the demand side in full competition leading to the most efficient outcome for all consumers.

What is concerning about the structure of the NEM is that at certain times, some generators have the ability to make rebids which are not made with the constraint of competition and therefore do not reflect efficient dispatch. In particular, the later the rebidding is made, the more difficult it is for the demand side to participate in the market. The lower the involvement of the demand side in the market, the less efficient the market outcome will be.

The Options Paper confirms that the issue of late rebidding is impacting the market to the extent that some action is required to eliminate this element of the exercise of market power by some generators. The MEU agrees with the AEMC that this is the case from its own research into the issue. In particular, the MEU advises that a number of its members who effectively act to provide demand side responses in the market have provided observations that they have not been able to respond to late rebids by some generators due to time constraints and have thereby incurred higher costs for their electricity supplies than would be expected from an outcome based on full competition.

In this regard, the MEU notes that the research undertaken for the AEMC examines the impact of late rebidding in terms of the market as a whole. MEU members have advised that the impacts on their operations have been quite significant in terms of their profitability. So while the AEMC research implies that the issue might have a moderate impact on the market, the impact on individual consumers (and even some generators) in the market can be extraordinarily high. This is an aspect that the AEMC needs to recognise.

The options being considered by the AEMC lie in two distinct avenues:

- Controlling market participants through behavioural means, or
- Modifying the market to preclude certain actions.

The MEU considers that attempting to control the behaviour of market participants is much less certain than modifying the market itself. For example, the recent decision of the Federal court to fine Snowy Hydro for failing to comply with a direction of AEMO provides a much more robust approach than the attempt by the AER to impose a penalty on Stanwell for not complying with the expected behaviour implicit in the rules.

With this in mind, the MEU considers that its preferred outcome is to have the rules clear as to what and what in not acceptable practice is much more likely to achieve the targeted outcome than requiring compliance with behavioural constraints as there is a clear difficulty in "proving" that an action by a generator was deliberate and not accidental. However, the MEU agrees with the AEMC that the two options are not mutually exclusive and both could be implemented.

Behavioural options

Option 1 is for no change. This is unacceptable unless there is some other tool implemented to prevent the recurrence of the problem

Option 2 is to remove the requirement there be a change in circumstance or conditions and replace it with the generator's expectation of what it hoped to achieve under the circumstances expected. The AEMC notes that it might be difficult to prove there were deliberate actions to subvert the intention of the rules and the MEU agrees. The MEU also notes that the genuine expectation might be to make a certain amount of money and therefore a bid or rebid could be made with a profit motive as well as for the other reasons the AEMC notes. Without a change in obligation from the AER having to "prove" generator guilty to the generator having to "prove" its innocence, the MEU concurs with the AEMC that this option is unlikely to achieve the targeted outcome

Option 3 is to apply a different statement of behavioural conduct which is to be prevented. The MEU agrees that such an option is preferable to the other two behavioural options countenanced and also agrees that focusing on the actual and observable actions of generators is more likely to achieve the outcomes sought. The MEU considers that this option could well be implemented in concert with other actions to limit generator rebidding.

Rebidding options

Rebidding options revolve around what limits should apply to rebids and then how long ahead of the dispatch interval the gate should close. The AEMC posits 5 limitations on the reasons for rebids and 4 options for the timing of the gate closure.

Restrictions on rebidding

Option A. No rebidding permitted. The MEU considers that this is not practical as there may be many legitimate reasons for rebidding. The MEU also notes that when NECA reviewed the issue of rebidding, it observed that over 90% of rebids were to reduce prices. The MEU is not aware if this proportion is still being seen in the market, but considers that there is still considerable rebidding down occurring. Therefore a total ban on rebidding is not seen as practical nor would it seem to meet the NEO.

Options B, C, and D place limits on what is allowed to make a rebid. The MEU considers there are other legitimate causes that might trigger the need for a rebid than just physical prevention, safety or technical characteristics which are what the AEMC proposes as legitimate reasons for a generator to make a rebid.

For example, the market might exhibit considerable change which might require rebidding to ensure there was an efficient outcome. This was the issue raised by the SA government that rebids should be prevented unless there was an identifiable and significant change in the market. As noted for option A, there are many rebids which are made (both "up" and "down") and limiting the reasons allowed for a rebid to be purely related to generator issues would be unlikely to capture causes that are market related and might also limit the "down" rebids currently seen in the market.

Option B would have to overcome the issue that most generation units are bid as part of a portfolio and the portfolio approach is used to limit the risks of failure of a single generation unit. Whilst the MEU considers there is some merit in this option, it would have to reflect the fact that most bids and rebids are predicated on there being a portfolio of generation units serving the market.

Option C raises the issue of bidding on the basis of a portfolio of generators where issues related to one generator are overcome by using another generator in the fleet. In theory, a portfolio allows the owner to use another generator to maintain its commitment to the market in the event of failure of the first generator. Option C would effectively allow a rebid from another generator from the fleet at a higher price to reflect the loss from the first. Competing generators would not be allowed to rebid even though the market had significantly changed giving the portfolio generator the ability to exercise market power.

Option D introduces the issue of the market being intended to be technologically indifferent so that all generators can compete on the same basis. This aspect was considered to be a major issue in the discussion on the AER ramp rate rule change proposal.

Option E increases reporting requirements. The current reporting requirements for rebidding are minimal and allow profit enhancement as a legitimate reason for rebidding. The SA government rule change was to increase the ability of the AER to identify and then prove that a generator is misusing the rebidding rules to its advantage. Increased reporting is therefore a core element of the proposed rule change. But as rebidding can occur many times from many sources for each dispatch period, reporting for every rebid then becomes a massive exercise. What is being sought is the ability to identify and then control of when rebidding is being used to disadvantage the market; this point is made by the AEMC in its consideration of behavioural option 3.

What is required is an ability of the AER, after identifying there might be misuse of the rebidding function, to identify if there was misuse for profit enhancement rather than from actions reflecting the changed conditions in the market (which would include the technical reasons identified by the AEMC for options B, C and D). So rather than imposing increased reporting on each rebid, the requirement should be that if the AER requires more information about rebidding, the generator would be required to provide its reasons for the rebidding it made. If the generator cannot satisfy the AER that its reasons were acceptable and compliant with the rules, then the AER would be able to initiate the imposition of a sanction. To a large extent this is what was sought in the initial rule change proposal.

Effectively, increased reporting will not be sufficient without there being some change to the rules to minimise the ability of a generator to use rebidding which does not meet the behavioural intent of the rules or where the outcome does not meet the NEO.

Timing of rebids

The timing options address only restricted rebids. Therefore under restriction option E the timing options would not apply.

The MEU offers the following considerations for review of the timing options

- The longer the time between gate closure and the dispatch interval the more able the demand side will be to participate in the market as the demand side actions are not purely driven by the needs of the electricity market (a distinct point of differentiation to generators) and are more influenced by a number of other factors. Few users of electricity are able to offer power back into the market as fast as generators.

Therefore the longer the time period prior to the dispatch period, the more competition will be enabled through demand side participation.

- A demand side response to the market will, in almost every case, not be tied to a single dispatch period and probably not even to a single trading period. Most demand side responses take time to implement and once implemented are difficult to reverse without considerable time involvement.

This means that actions on rebidding need to span a longer period than a single trading period (timing option 1) and possibly longer than the window for timing option 2.

Timing option 3 reflects in principle how the demand side actions are most likely to be implemented but the duration (one trading interval) is probably too short to achieve the needs of the demand side. The combination of timing option 3 extended to two trading periods (timing option 2) would seem to be more manageable from a demand side viewpoint than timing option 3 as proposed. The AEMC queries the ability of AEMO to manage such an approach and this issue needs to be assessed before a firm conclusion can be reached.

- The AEMC contemplates a moving restriction process where restrictions are made tighter the closer to the time of dispatch. This option has some attractions with regard to ensuring rebidding is made for the benefit of the market but does not provide an ability of the demand side to better participate in the market.

Conclusions

The options contemplated in the Options Paper do little to assist the demand side participate actively in the market where consumers can see the actual prices that will apply and on this take actions to minimise their exposure and to provide useful demand side actions to improve the efficiency of the market. This aspect needs to be addressed more fully in the discussion on which option is preferred.

The AEMC observes that whatever changes it makes must not impact on the investment decisions a generator might make; the AEMC sees that the proposed actions might restrict efficient investment in new generation and thereby undermine the long term efficiency of the market. Such an observation does not recognise that consumers also make long term decisions about their investments based on the electricity market being efficient. To consider just the implications of investment on the supply side yet not on the demand side is blinkered thinking.

The MEU considers that a multiple approach might provide the best outcome for all, where:

- The AER intensifies its examination of rebidding practices
- The ability to rebid is limited by behavioural conduct requirements (ie to require compliant rebidding)
- Generators are required, on request from the AER, for more detailed reporting on the reasons for rebidding. This would give the AER the ability to take action where it considers rebidding is being misused
- Compliant rebidding is permitted up to 1 hour before its dispatch period; this allows the demand side sufficient time to enter the market
- Limited rebidding is permitted after gate closure for certain specific changes in the market