NATIONAL GENERATORS FORUM

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

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Dear Mr Pierce

The National Generators Forum (NGF) welcomes the opportunity to comment on the Bidding in Good Faith rule change proposal, as published by the AEMC on 10 March 2014.

The NGF is the national industry association representing private and government-owned electricity generators. NGF members operate all generation technologies, including coal-fired plant, gas-fired plant, hydroelectric plant and wind farms.

The NGF considers that the questions in the consultation paper only address a small subset of our concerns and as such we have structured the response in two parts. The first part is a general response and the second part addresses answers to the specific questions in the issues paper.

We would welcome the opportunity discuss the matters raised in this submission. Please contract Luke Van Boeckel on (07) 3228 4529 should you wish to discuss this submission.

Yours sincerely

Tim Reardon
Executive Director

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Executive Summary

The concepts identified by the Proponent in the original rule change request do not warrant fundamental market design changes, and the specific change proposed would be significantly detrimental to the NEO. The NGF acknowledges that the issue of 5 minute dispatch and 30 minute settlement raised in the AEMC issues paper may warrant further investigation in a separate review although the NGF does not consider that it represents a failing of market design.

With respect to the concepts referenced in the rule change request and consultation paper, the NGF considers

- There is no evidence that there is a problem with either the Rules around good faith bidding or generator behaviour with respect to good faith bidding. Rebidding in the NEM has an excellent and continuously improving compliance record, and this is supported by the AER Quarterly compliance reports and the infrequency of enforcement action.
- There is no evidence that the existing regulator powers are insufficient, or that the Federal Court decision of 2011 creates additional uncertainty regarding good faith bidding. The existing powers under Section 28 of the NEL already provide the Regulator with comprehensive investigatory and information gathering powers. The NGF does not consider that a single unsuccessful prosecution implies that there is a problem as indicated by the Proponent. In this context, proposals to force market participants to give the AER a complete account of their reasons for rebidding prior to an allegation of wrongdoing are unnecessary, and risk putting market participants in a position where compliance with the law will be a practical impossibility.
- There is no evidence of generator market power or inappropriately high premiums for customers as a consequence of current rebidding practices. Rather the comprehensive review undertaken by the AEMC in 2012 showed that pool prices are well below LRMC estimates in all states when considered over any period relevant to a long lived investment such as generation. The NGF considers that updating that analysis in 2014 would provide very similar outcomes.
- There is no evidence that "late strategic rebidding" materially detracts from the accuracy or usefulness of Pre-Dispatch. The Reliability Panel has recently finalised the Annual Market Performance Review 2013 which addresses the issue of Predispatch accuracy in section 5.2.8 and Appendix 4.6 and concludes "*The Panel considers that pre-dispatch has been working satisfactorily as an indicator of reliability and security. Its utility to the market however, will always be affected by the accuracy of demand forecasts, as demonstrated by an* ***increase in price variations due to variances in demand values from the previous AMPR****. As previously observed, the Panel notes that load forecasting is a continuing challenge."* (emphasis added). The NGF recommends that this assessment – including the detailed information on the source of Pre-Dispatch variations - be kept front of mind when evaluating the materiality of the "problem" identified by this rule change request. The NGF considers that the existence of non-transparent market participation (non-market and non scheduled generation and load) and inherent forecast inaccuracy are more significant concerns for users of Pre-Dispatch than rebidding.
- Disorderly bidding has been repeatedly shown to be of negligible consequence to the market.

The NGF considers that the specific rule change proposed – and indeed the general concept of changes to the good faith provisions – create significant undesirable effects which are detrimental to the NEO in an attempt to address a problem which does not exist. As such the NGF strongly opposes the proposal.

Part 1 - General concerns with the proposal

The NEM has an excellent compliance record with ongoing improvement

Since the introduction of the good faith bidding requirements in 2002, a number of additional and updated provisions have been introduced which are not recognised in the Proponents rule change proposal. Generator rebidding compliance has been of a high standard and continues to improve through sensible, meaningful consultation with Regulators. This is highlighted by the fact that in the 12 years of good faith bidding there has only been one court action and 9 fines issued[1] despite an enormous number of rebids and a significant number of AER requests for additional information.

Further, the AER published the *Rebidding and Technical Parameters Guideline* in 2009[2] providing additional direction on the requirements of rebids, and a *compliance bulletin* in 2010[3]. Both of these initiatives lead to a significant improvement in the quality of rebidding in the view of the AER. There have also been a number of rule changes in relation to rebidding including the 2009 change to the requirements for ramp rate, FCAS and Fast Start Inflexibility Profiles, removing a large number of the rebids which had historically been of concern to the AER.

The NGF considers that the current arrangements represent a pragmatic approach by all Participants whereby the Regulator requests additional information which is then duly provided by rebidding Participants. Should this information not fully satisfy the Regulator, a further request is issued and additional qualifying information can be provided by the Participant. Under this regime a large number of rebids are investigated and found to be compliant based on sufficient but not necessarily "complete" information. The proposed rule change would remove this ability for Participants to provide a "sensible" level of information and risk swamping the Regulator in unrequired information in response to each request. The NGF also notes that the Regulator currently has access to the Section 28 provisions of the NEL which empowers the AER to seek and obtain whatever information it needs to assess and enforce compliance with any provision of the NEL should it feel that the initial data provision(s) are insufficient.

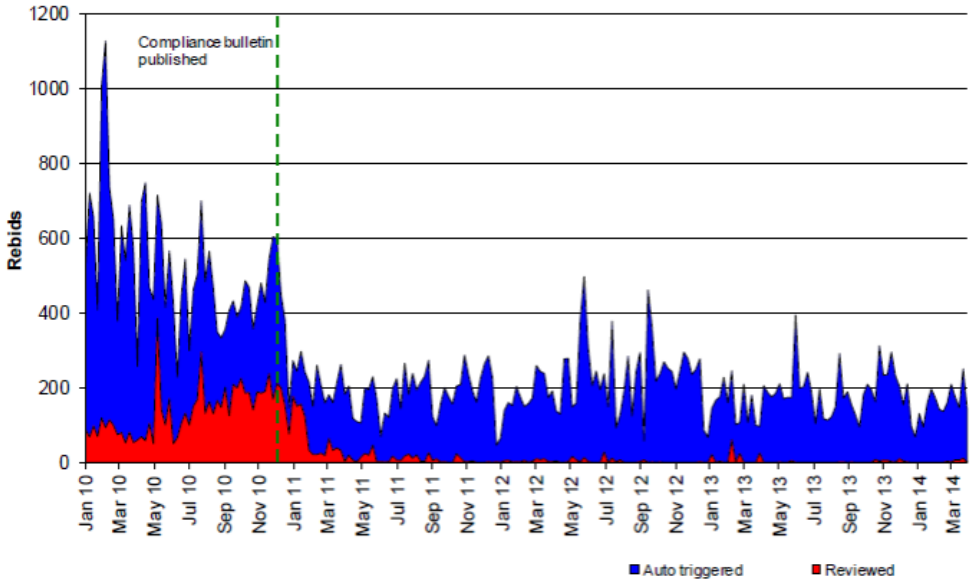
The chart below is sourced from the AER's Quarterly compliance report for March 2014 and shows that bids of interest to the AER have remained fairly consistent since 2010 with extremely low instances of further investigation being considered appropriate[4]. The NGF considers that this is proof that rebidding and the good faith provisions are not a "problem" which needs to be addressed through

[1] NERA/Allens Linklaters report to SCER, *Review of Enforcement Regimes under the National Energy Laws*, 2013, page 67. "9 infringement notices have been issued under the NEL/NER".
[2] http://www.aer.gov.au/node/346
[3] http://www.aer.gov.au/node/15433 originally issued 7 December 2010, amended 4 June 2012
[4] "Reviewed" rebids on this chart indicate rebids which the AER did not accept after an initial, brief, internal review. They include for example rebids for which there was a later correcting rebid or which had very small impact (1MW). The number of formal communications with counterparties forms a subset of these rebids.

significant changes to market design.

Figure 2.1 shows that since 2010 the number of rebids detected by our internal compliance system has fallen markedly. The number of rebids which required further review has also fallen significantly.

Figure 2.1 Rebids auto-triggered and reviewed per week



"strategic rebidding" is a fundamental, desirable aspect of market design

In an energy only market such as the NEM only economic theorists assume that generators bid at SRMC as this would in fact guarantee that the most marginal unit (at a minimum) would be uneconomic as it would never recover fixed costs. This is because as the marginal unit it would only be dispatched to full capacity a small portion of each year, if at all.[5]

More materially, in a market where demand shows such striking fluctuations between years it is extremely unlikely that supply will be sustainably balanced in relation to peak demand. Given the broader context of electricity as an essential service this leads to persistent structural oversupply.

In an oversupplied (or even marginally supplied) market, peaking plant is unlikely to be dispatched sufficiently to recover fixed costs and will rely on contract premiums, intra-company portfolio benefits or economic withholding from other (lower cost) plant to remain viable[6]. In order for contract premiums to remain sufficient to contribute to the continued (largely non-operating) existence of the peaker, retail/consumer Participants must consider that there is sufficient risk from *not* hedging their peak exposure to make it worth paying that premium.

Similarly, low and mid-merit generators need sufficient revenue to recover both their variable and fixed costs[7], however such plant are exposed to both peak (demand) and average (energy) oversupply. In an oversupplied market, price and/or capacity factors will be under pressure for most plant with a

[5] NGF analysis of load duration curves for mainland NEM regions shows that up to almost 30% of dispatched plant would run less than 1% of the year in a simple merit order scenario. In addition, as average demand is declining faster than peak demand the amount of dispatched plant operating less than 1% of the year is increasing.

[6] That is, another participant would have to *not* dispatch sufficient generation to both have price high enough and allow the peaker sufficient dispatch to be run at economical levels.

[7] AEMC *Potential Generator Market Power in the NEM - Final Rule Determination*, page 4. "In an energy-only market such as the NEM, the costs of the generating units, including fixed costs, must be recovered over time through sales of electricity by way of spot and contract markets"

resulting reduction in margin for large portions of the year. This is reflected in the results of the recent study[8] which showed that with the possible exception of a short period in the South Australian region market prices have been consistently below LRMC since demand peaked in 2008.

In the proceedings against Stanwell, both the AER and the Federal Court recognised that a generator, acting in good faith, might elect not to offer its full capacity into the market at a given price, with the Court finding (at paragraph [335] of its judgment):

> *"The applicant* [ie. the AER] *also accepts that a trader might rebid, intending to put pressure on the Dispatch Price, by reducing the volume of energy in lower bands and increasing the volume in higher bands. One might well ask how else the market could have operated in order to produce the occasional high prices which both base load and peaking generators relied upon to recoup their capital investments, as Dr Rose demonstrated. Clearly, occasional high prices were contemplated by the very fact that the range of prices was so wide."*

The Court was simply recognising what is, in fact, an uncontroversial feature of the NEM. The fact that a generator might elect not to offer its capacity into the market at a given price (so called "economic withholding") is a feature of the design of the spot market, and is common to most markets for most goods and services.

The Proponent makes unsupported claims relating to the "benefit" of the proposal, and the AEMC assessment framework appears weighted towards accepting the definition of alleged problems rather than questioning it.

The rule change proposal makes claims to sweeping benefits which are to arise from the rule change but provides no substantiation of such claims. Specifically, without justification or analysis, the Proponent claims that the proposal will:[9]

- Enhance economically efficient outcomes during periods of high demand;
- Facilitate a more considered analysis of market behaviours;
- Improve price transparency in the wholesale spot market;
- Promote certainty for market participants;
- Promote competition in the energy retail market;,
- Improve liquidity in the futures market; and
- Provide economically efficient signals for investment in electricity generation.

In addition, the "problem" is not adequately defined or quantified and the AEMC consultation paper appears to simply accept the Proponents assertion that there is a problem and it needs to be fixed.
In the issues paper the AEMC states:

> *"However, concerns are raised by the Proponent that generators engaging in late strategic bidding practices provides insufficient time for participants to respond which may reduce the predictability and efficiency of wholesale price outcomes and lead to higher risk management costs for consumers.*
> *Further, that an inability of participants to respond efficiently to short-term price signals may limit the extent to which price outcomes accurately reflect conditions of supply and demand and underlying cost structures, and that lack of transparency in price outcomes may hinder long-term investments.*

[8] NERA/Oakley Greenwood "Additional estimates of the LRMC for the NEM" 22 November 2012. Figures 3.1, 3.3. 3.5 and3.7.
Accessed via AEMC website 13 May 2014
http://www.aemc.gov.au/getattachment/2a71b43a-3d42-43b6-86ef-23f4c5fb22a3/NERA-report.aspx
[9] Proponent Rule change request, page 16

These concerns raised by the Proponent are a useful basis from which to determine the extent of the problem or market failure."

While acknowledging that the AEMC intends to separate defining the problem from assessing its materiality, the NGF considers that some critical examination of the Proponent's statements would be appropriate prior to releasing the proposal for industry review.

As an example, it is generally accepted that the baseline (pre-rebid) environment would logically include Participants submitting bids with regard to underlying cost structures and that the resulting market outcome would reflect conditions of supply and demand. A rebid by one Participant may impact the financial incentives of other Participants, but would not affect the underlying cost structures nor the conditions of supply and demand (other than as specifically desired per the rebid). Accordingly, the inability of Participants to respond to the price signals arising from such rebidding (if such inability exists) could not be said to limit the extent to which price outcomes accurately reflect conditions of supply and demand and/or underlying cost structures.

Similarly, it is generally assumed (by Proponents and regulators) that the baseline environment includes efficiency of dispatch and that rebidding moves the market *away* from this level of efficiency. It follows that subsequent rebidding (in response to the initial rebid) would move the market *further* from the efficient baseline rather than towards it.

The EnergyAustralia (EA) presentation to the AEMC workshop highlighted the significant rebidding which occurred in the period of market stress in January 2014 (extreme high Victorian demand) and the savings to the market which resulted in generators being able to rebid in response to the resulting highly complex and dynamic environments. Any Rule change that aims to inhibit or restrict participants from rebidding will reduce the efficiency of the market and will therefore be detrimental to the NEO. It is highly doubtful that the proposed rule change could drive any greater economic efficiencies from that high demand event than the current rules provided.

Prior to the commencement of the NEM in 1998, Queensland operated an Interim Market, in which generators were forbidden from moving capacity into higher price bands within 90 minutes of the commencement of the relevant trading interval. This rule operated in the Queensland region of the NEM until 1999 when it was removed, in part because generators had responded by establishing what was, in effect, a 'Dutch auction', which was seen as resulting in higher prices in the spot market.[10] The history of the NEM demonstrates that, once the market design is modified to prevent generators responding to price and demand signals, it is far more likely to move the market away from efficient outcomes, rather than drive the market towards it. This basic proposition must be kept front of mind in the context of a rule change proposal which is, in essence, an attempt to substantially discourage, if not actually curtail, rebidding in the spot market. As detailed below, the AEMC have recently completed a large body of work which confirms that wholesale spot and contract prices are consistent with a workably competitive market and as such the claim that consumers are facing higher risk management costs than necessary is unfounded.

De facto reversal of the onus of proof on good faith rebidding

The NGF is strongly concerned about the proposed de facto reversal of the onus of proof on good faith rebidding and the consequential impact on generators and their employees. This issue is also discussed in Question 3.

The NGF shows comprehensively in this submission that there has been no case made for a change in the good faith bidding provisions. Moreover in 2002, the ACCC declined to authorise amendments

[10] The Queensland '90 minute rule', as well as the history of rebidding in the NEM, is canvassed in a paper presented to the 2011 AMPLA conference (Oliver, "*Good Faith Rebidding in the National Electricity Market: A Solution in Search of a Problem*" [2011] AMPLA Yearbook, page 165).

that would have deemed a market participant to have made a rebid in bad faith unless it could prove otherwise and the NGF considers that the reasons for the ACCC's rejection of this proposal in 2002 remain valid today.

The NGF notes the Proponent and AER have expressed the view that the proposal does not, in fact, reverse the onus of proof as it does not contain the explicit statement to this effect that was contained in the original NECA proposal. While the NGF acknowledges that the Regulator would still hold the legal burden of proof, the proposed rule change creates a situation where a generator must prove its innocence to the Regulator rather than the courts. Specifically, while a generator may consider that a certain information set is sufficient to show good faith, if the Regulator disagrees there would be no avenue for the generator to provide additional qualification without causing an ex-post breach of the good faith provision.

The NGF considers that the proposed changes make the existing section 28 powers redundant (as no additional information could be provided) and marginalises the court process. Any witness testimony would risk an ex-post breach of the good faith rules, making the judge equivalent to an independent expert deciding which interpretation of a dataset is the most appropriate.

The proposal is inconsistent with the original NEM design and has significant overlap with concurrent processes

The NGF also considers that the proposal is inconsistent with the Code Objective[11] of "*providing a regime of light handed regulation*". The NGF also note the NEC design principles reference *"… allow Market Participants the greatest amount of commercial freedom to decide how they will operate in the market*" and "*avoidance of any special treatment in respect of different technologies used by Market Participants*"[12].

The NGF considers that this proposal is totally inconsistent with the concept of "light handed regulation".

The NGF considers it appropriate to view the proposal both in isolation and in conjunction with other proposed changes to the NEM which are running concurrently. This suggested parallel consideration of issues does not appear to be being undertaken by the AEMC. With respect to bidding these proposals include:

- changes to the NEM enforcement regimes;
- changes to rebidding of ramp rates and Fast start profiles;
- Optional Firm Access;
- Power of Choice;
- the expansion of rebid fields from 64 to 300 characters; and
- the proposed AER market monitoring powers arising from the exercise of market power review.

It will be important to consider whether the progression of one or more of these overlapping proposals affects the need for, or scope of, the other proposals.

The NGF are concerned that this rule change proposal explicitly favours certain technologies and Participant classes. In particular the NGF note that the proposal only applies to a subset of Participants (being market scheduled generators and loads) while other technologies and behaviours

[11] The National Electricity Code has been superseded by the NER/NEL and its focus on a single NEO, however the NGF consider that the Code Objective and Design Principles remain relevant, particularly when discussing the good faith bidding provisions which were introduced under the Code.
[12] NEC 3.1.4(a)(1) and 3.1.4(a)(3)

which affect market transparency remain unaffected, including demand side response. The NGF notes that the Proponent has explicitly stated its support for demand side response through the Demand Response Mechanism proposal contained in the Power of Choice review. The NGF are also supportive of demand side response where it is transparent, accountable and does not result in any special treatment in respect of different technologies.

More broadly, the NGF supports well considered and implemented measures to increase the accuracy, reliability and transparency of market data including pre-dispatch. Accordingly we consider that the AER, AEMC and AEMO should focus their efforts on improving market information with respect to all technologies and Participants rather than increasing burdens on the most transparent elements. Such burdens have the perverse outcome of decreasing incentives for currently non-transparent activities to transition to full participation.

The Proponent repeatedly references *"…limiting the ability of a [market, dispatched] generator to engage in strategic withdrawal of generation capacity when other parties are unable to respond..".* This implies that certain Participant types including peaking generation, non-market generation and demand side response should be able to change their behaviour in response to market information later than other types of generators – especially those subject to good faith bidding requirements.

This rule change proposal needlessly increases regulatory burden on participants

The NGF considers that the bulk of this process repeats recent work by the AEMC, AER and participants and such, the effort and expense being incurred by participants and regulators in this process is unwarranted. This is particularly disappointing given the AEMC's acknowledgement that "*We need to strike a balance between ensuring sufficient consultation on, and transparency of, our decisions, and minimising the regulatory burden on stakeholders*."[13]

The AEMC has recently completed a large body of work in relation to generator market power and rebidding in the NEM and concluded that "*Spot price volatility is an inherent and necessary feature of a market with the characteristics of the NEM*" and "*The Commission considers that transient pricing power, manifesting itself through occasional spot price spikes, is an inherent feature of a workably competitive wholesale market, and is only a concern if it occurs frequently enough and to a significant enough magnitude to lead to average annual wholesale prices being above the long-run marginal cost (LRMC) of generation*" The commission also found that with the possible exception of South Australia in 2007-08 to 2009-10 the wholesale spot and contract markets "*shows results which are consistent with a wholesale electricity market that responds to the supply demand position broadly in the way that would be expected of a workably competitive market*" [14]. Given that this extensive body of work has shown that prices are generally at or below expectations of an efficient market, the NGF considers it inappropriate that Participants and Regulators should be required to immediately, and at great expense, delve back into whether there is a problem with pricing in the wholesale market and to question fundamental aspects of market design.

The AER regularly review compliance with rebidding rules and report continued low instances of follow up investigation being required. Where AER follow up has been required, correspondence between the AER and Participant has been sufficient to provide clarity to the AER that the rebidding was appropriate.

The NGF are concerned that the Proponent is attempting to effectively reverse the burden of proof, through an investigation tool, without consideration of the market and regulatory developments that have occurred since the introduction of these good faith bidding provisions. Specifically, the publication of the AER *Rebidding and Technical Parameters Guideline* in 2009 and a special *Compliance*

[13] AEMC *Strategic Priorities for Energy Market Development 2013*, p36.
[14] AEMC *Potential generator market power in the NEM - Final Determination*, 26 April 2013, Pages 4-5.

Bulletin in 2010 are examples of constructive interaction between participants and the AER to refine participant behaviour without subverting market fundamentals.

The Proponent conflates issues, creating an inappropriate view of the risks in relation to rebidding

The NGF considers that the Proponent has inappropriately conflated the issues of economic and physical withholding of capacity in order to bring the spectre of insecure supply into a proposal focussed on price and the accuracy of predispatch. In its submission, the Proponent states "*The market operator also relies on pre-dispatch forecasts for its reliability forecasts. If rebids alter the availability of generation, it directly impacts the reliability forecasts that the market operator produces. The market operator may be required to intervene in the market to recall transmission lines or generation for system reliability and security. These actions have an associated cost."*[15]

The NGF considers that there is no evidence of security of supply having been threatened due to non-technical changes to generator availability and as such the inclusion of such content creates undue bias in consideration of the proposal.

The Proponent also attempts to relate the rule change request to disorderly bidding through reference to the AER's 2012 special report. This is inappropriate as disorderly bidding (as described in that report) occurs under abnormal market conditions and so is unrelated to the accuracy of predispatch. The NGF considers that this is also inappropriate in the face of evidence that the cost of disorderly bidding is insignificant in the scope of the NEM.

- Reports commissioned by the AEMC in 2008[16] and 2013[17], AEMO in 2012[18] and NGF/Clean Energy Council in 2013[19] have all characterised "disorderly bidding" as costing a fraction of a percent of the resource cost of the NEM using conservative (high) estimates.
- The OFA process currently being undertaken by the AEMC was originally costed at $5m over 12 months[20] and is in addition to numerous reports and rule change requests targeted as "disorderly bidding" over the same timeframe.
- The cost of participant and regulator responses to these processes is difficult to quantify but likely runs into the millions of dollars per year in aggregate. This includes the costs of consultants and lawyers hired by participants in order to respond to regulatory processes. The total cost to participants is likely to be greater than the cost of disorderly bidding.
- These costs caused by the current onerous regulatory environment are implicitly passed on to consumers in order for market participants to remain viable.
- In addition to above the root cause of these market events highlighted in the AER's Special Report was transmission outages taken out at inappropriate times. "Disorderly bidding" was in response to these transmission outages. The NGF believes the AER should focus on improving transmission incentives to reduce the incidence of these market events in the first place.

[15] Proponent Rule change eequest, page 4
[16] Frontier Economics contribution to AEMC *Congestion Management Review – Final Report*, June 2008, Appendix B.4.1.2, pp90-101
[17] ROAM Consulting, *Modelling Transmission Frameworks Review*, 28 February 2013
[18] IES report to AEMO, *Modelling the SACP model*, 23 April 2012.
[19] Frontier Economics, *Economic Costs of Disorderly Bidding*, 2013
[20] AEMC *Transmission Frameworks Review - Final Report*, pp 12

Part 2 – Response to Questions in the Consultation Paper

Question1

Do you consider late strategic rebidding to be the primary issue raised by this rule change request?
No.

While noting that a significant portion of the AEMC issues paper relates to generator conduct classified as "late strategic rebidding", the NGF would consider that the primary issue raised by the proposal is the reliability and accuracy of Pre-dispatch. This submission assumes that "Pre-dispatch" is a reference to 30 minute pre-dispatch unless explicitly stated otherwise. The NGF considers that the Proponent makes a false link between generator rebidding and pre-dispatch inaccuracy and uses this as the basis for a proposal of fundamental changes to rebidding rules with the aim of increasing the likelihood of successful AER prosecutions including "false positives".

The proposal also does nothing to address numerous other significant sources of inaccuracy in PD other than "late strategic rebidding".

The NGF notes that the Proponent disagrees with the Federal Court's interpretation of the rules as they stood in February 2008. In comments made at the AEMC's public forum, the Proponent's representatives confirmed that the proposed rule change is intended (and drafted) to "make it easier to pursue generators" despite presenting no evidence that there is a problem with generator good faith bidding.

The proposal is based on the Proponent's opinion that there is a risk that generators *could* start bidding in bad faith in response to the Federal Court verdict[21]. The NGF do not support this view and neither do the AER's compliance statistics. More than two years have elapsed between the verdict in the Stanwell case and the submission of the rule change request. In that time no evidence of such conduct has arisen[22]. The AER has commenced no proceeding. Nor, to the knowledge of the NGF, has it used its information gathering powers in the conduct of an investigation into a suspected breach of clause 3.8.22A. Allegations of rebidding in bad faith have not featured in the AER's compliance reports. While the absence of enforcement action by the AER is not sufficient to prove that there is uniform compliance with clause 3.8.22A, it is a fact that indicates, quite strongly, that the overall level of compliance is high.

This returns to the question of what the "problem" being identified actually is. Do the Proponents – either unilaterally or on behalf of the AER - consider that bad faith rebidding *is* occurring or simply that it *could* occur?

- If bad faith bidding *is not* occurring under the current rules, why does the Proponent consider that the disincentives for generators to perform such actions will change in the future? That is, what is the rationale for a change to a regime which is working and has continued to work beyond the Federal Court's decision?
- If bad faith bidding *is* considered to be occurring, why have there not been more attempts at enforcement action, or at least the pursuit of potential breaches through investigation? Any rational observer would acknowledge that a dataset of one instance is not sufficient to determine whether a trend or rule can be established. Put another way, we might well ask the Proponent if a single instance of a successful prosecution under the existing Law allay the Proponent's apparent concern regarding the AER's ability to prosecute bad faith bidding?

[21] Proponent Rule change request, page 1.

- The fact that prosecution of a suspected breach is challenging is not to be regarded as a deficiency in the law. The Federal Court has the power to impose a penalty of up to $1 million for a violation of clause 3.8.22A. It is perfectly proper for the government to be required to prove its case before such fines are imposed. If the AER considers that bad faith rebidding is occurring in the NEM, consumers might reasonably ask why the AER has not made greater use of its information gathering powers to investigate such conduct. If, after assembling a proper brief of evidence, the AER receives independent advice that a case cannot succeed due to some defect in the law, there may be a legislative issue that needs to be addressed. There is, however, nothing in the Proponent's submission or in the AER's supporting comments, to suggest this has occurred since the Stanwell decision.

The proposal places a strikingly different regulatory burden on rebidding participants than that which occurs in other aspects of Australian business or, for that matter international energy markets. The proposal will affect all rebids regardless of the time prior to dispatch and hence cannot be said to be related specifically to “late” rebidding.

The NGF also notes that at the time that good faith bidding was introduced neither 5 minute pre-dispatch or intra-day generator output were published in the market. These additional datasets provide participants with a more timely update of AEMO forecasts and market conditions than was available in 2002. The so-called "information shadow" in which generators can apparently rebid without facing a response from the market, is now rarely longer than a single dispatch interval and this is the practical limitation of the market.

5 minute predispatch however remains greatly affected by the inaccuracies in the AEMO forecasting process and the increasing penetration of non market and/or non scheduled generation and load. None of these inaccuracies will be improved by the proposal or any rule change regarding good faith bidding.

In the interest of market transparency and to promote price discovery for all classes of Participants the NGF believes that non-scheduled generation and load must have more consistent requirements to signal their intended response in the NEM.

Question 2

Do you consider the NEM trading arrangements of five-minute dispatch and 30 minute settlement to be relevant to the issue of late strategic rebidding? Do you have any views as to how any issues arising could be addressed?

The NGF reiterates that we do not consider that late strategic rebidding is the primary issue raised by the proposal. More specifically 5/30 minute issues arise in relation to a period where 30 Minute Pre-dispatch is not updated and as such has a very weak link to the accuracy of 30 minute PD forecasts. By contrast, all changes including those related to rebidding are reflected in 5 minute PD at the earliest opportunity.

The NGF considers that there is a link between this element of market design and rebidding, however the relationship is complex and likely to be very much at the margin in respect to a generator's decision whether to rebid or not.

The behaviour characterised by the Proponent is presumably undertaken with the intent of increasing a measure such as margin or profit – the specific reason will depend on the company and circumstances at the time. The difference in the calculation of margin/profit on a 5 minute or 30 minutes time scale is unlikely to change the circumstances in which such action is considered economic as such a decision needs to include factors such as ramp rates, variable generator output, co-optimisation of constraints and FCAS markets, the status of other plant in the participant's portfolio and an expectation of competitor responses.

Such a change to market design would need a significant amount of thought and modelling and likely a number of supporting changes. The NGF does not support this rule change proposal being considered a reason to make such a fundamental change to market design as the proposal neither defines a problem not explains its magnitude adequately.

The NGF also notes that a generator's contract position is likely to be a material input into a generator's bidding and rebidding decisions, and that a change to the settlement processes of the NEM would likely result in different contract formulations. Such changes may or may not give rise to changes in participant incentives and behaviours or even contract market liquidity. These potential effects need to be carefully considered prior to implementing such a fundamental change.

The NGF also notes that a change to 5 minute dispatch and 30 minute settlement would have no impact on the ability for generators to rebid and - assuming as this question does that this is the intent of the proposed rule change - would therefore not address the "issue" relevant to the Rule Change proposal.

The idea that a generator might seek to rebid late in a trading interval, in the hope of increasing the spot price over the entire interval, is neither novel nor secret. Generators are fully aware that such conduct:

(a) would be transparent to the AER and the market more widely;
(b) could be easily investigated by the AER using its powers under clause 3.8.22(c) of the NER and section 28 of the NEL; and
(c) absent a material change in circumstances, would almost certainly be prohibited by clause 3.8.22A.

The performance of generators in the market suggests that the existing law is well understood and is effective. Further changes to the rules are not warranted to address this issue.

Question 3

Do you consider there to be benefits in the proposed rule to reverse the onus of proof onto generators?

No.

The NGF notes that the Proponent and the AER have indicated that they do not consider the proposal to be a reversal of the onus of proof[23]. The NGF concur that the legal onus of proof is not technically reversed, in the sense that the AER would still have the burden of proving, in any court proceeding alleging a breach of clause 3.8.22A, that the generator lacked the intent required by clause 3.8.22A(b) (as amended).

However, the proposal contains a de facto reversal of the burden of proof which is far more serious, in that participants would have to prove their innocence to the regulator prior to a case being brought against them.

The amendments to clause 3.8.22A(b) are coupled with a new clause 3.8.22A(d) that would empower the AER to demand from a market participant *'accurate and complete data and information to substantiate*' that the rebid complied with clause 3.8.22A(a).

The proponent is open about the fact that this rule is intended to force a market participant to provide all relevant evidence substantiating its rebid to the regulator, and to prevent the market participant from then leading any further evidence before the court should the AER take legal action.[24]

In practical terms, the inevitable effect of such a rule will be to place a burden on the market participant to produce evidence that will prove its innocence, not to the court, but to the AER at the first point of inquiry. If the market participant fails to produce evidence to the AER at this time that proves that it had the requisite intent, the market participant can be pursued either for a failure to make its rebid in good faith or, if it subsequently seeks to justify its rebids to the Regulator or before the court by reference to additional facts, for failing to produce that evidence to the AER when it was first demanded. The penalty in either case is the same. To suggest that this is not a reversal of the burden of proof is a semantic distinction at best.

In 2002, the ACCC declined to authorise amendments that would have deemed a market participant to have made a rebid in bad faith unless it could prove otherwise. The reasons for the ACCC's rejection of this proposal in 2002 remain valid today, in so far as they relate to the proposed new clause 3.8.22A(d).

In 2002 the ACCC stated:

> "*There is concern that the power to accuse a party of acting without good faith has the potential to impose significant costs on participants that are called upon to defend themselves. The Commission supports the principle that an accused party should be required to justify its actions if called to question.*
> *However, it believes that it is not unreasonable to require the Code Administrator to undertake such investigations as are necessary to build a substantive case before making such allegations, rather than the accused party having to prove it acted prudently before a case is made against them.*"[25]

[23] Verbal confirmation, AEMC workshop, 5 May 2014, Melbourne
[24] Proponent Rule change request, pages 9 and 13
[25] *Amendments to the National Electricity Code. Changes to bidding and rebidding rules (A90797, A90798, A90799), Final Determination*, ACCC, 4 December 2002, page 21.

The NGF agrees that an assessment of the practicality or feasibility of such a change would require a consideration of the wider precedent in law. The NGF considers that this necessary process would extend well beyond the timeframe applicable to this AEMC rule change process.

The NGF agrees that the proposal was inconsistent with the Code objective "to provide a regime of light-handed regulation".

The NGF agrees that it is reasonable that a substantive case should be required to be built before making allegations, rather than a Participant having to prove it acted prudently *before* a case is brought against them.

As generators already provide brief, verifiable reasons for rebids we already hold a significant component of the burden of proof. Under section 28 of the NEL, generators are also compelled to provide the AER with whatever information it needs to assess and enforce compliance with any provision of the NEL.

Further, as indicated by the Proponent, the "proving" of intent can be a difficult process subject to differences in opinion and the NGF considers that the risk of "false positive" cases would be extremely detrimental to the ability of generators to rebid in any circumstance.

The NGF agrees that the proposal has the potential to impose significant costs on participants. Any increased compliance burden will ultimately be passed on to consumers in order for market participants to remain viable. The EnergyAustralia presentation to the AEMC workshop highlighted that a single portfolio makes an average of around 50 rebids per day during non-volatile pricing periods. Under the proposed changes, participants would be obliged to retain much more comprehensive records of conditions and circumstances at the time of the rebid and must provide these to the regulator at their request.

Finally, the power to be given to the AER under the proposed clause 3.8.22A(d) could be used in way that makes compliance with the law a practical impossibility.

In its investigation of the events in Queensland on 22 and 23 February 2008, a section 28 notice was issued to Stanwell seeking detailed reasons for 92 rebids. Stanwell was required to respond within 36 business days (which included the Christmas/New Year period). If a generator received a request for particulars under clause 3.8.22A(d), framed in similar terms, it would have only a few hours (per rebid) to prepare a complete account of its reasons. In this time it would need to:

- examine market data, trading strategies, log books, phone records and other material;
- interview and record statements from relevant trading staff,

all in the knowledge that any omission or oversight would leave it exposed to a penalty of up to $1 million, either for failing to rebid in good faith or (if it subsequently sought to defend its actions in court by reference to additional facts) for failing to reference those facts when they were first sought.

In such circumstances, full compliance with the rules would a practical impossibility. A generator would be exposed to significant financial penalty as a consequence of a regulatory process with which they could not practically comply. Any suggestion that a generator, faced with such a demand, would be afforded any measure of procedural fairness is simply untenable.

The ACCC, in authorising the original changes, noted that "Restrictions could result in less competitive price outcomes leading to inefficient dispatch of generation". The NGF agrees that there is a concern

that the costs (and risks) of the proposal may encourage participants to bid and rebid more conservatively leading to less flexibility in the market. This may ultimately lead to an inefficient market. Such a regime would also be a deterrent to new market entrants. Both of these considerations are a detriment to the NEO for which the Proponent has failed to identify any overriding benefit.

The NGF notes that the risks faced by participants increase further when viewed in conjunction with the changes to NEM enforcement regimes currently under consideration by the Energy Council.

Question 4a)

Do you consider that all known conditions and circumstances should be taken into account in generator rebids?

Not in the manner implied by the Proponent.

Bids are undertaken for different reasons, and circumstances which are material to one bid may not be material to another. There is no logical basis for a market design which says that a change in circumstances, which was not relevant to a rebid, cannot therefore necessitate or justify a subsequent rebid if the change is plainly relevant to the subsequent rebid.

As noted by the AEMC (and the AER in the rebidding guidelines) a material change in conditions may be constituted by a number of smaller changes which in and of themselves were not considered material. Again, it would be inappropriate to exclude a change which is ultimately considered part of a material set of changes solely on the basis that it occurred prior to another bid/rebid.

Pre dispatch data (PD) is volatile as a result of it being purely a forecast. Participants currently may prefer to wait until a change is confirmed by a subsequent PD run before rebidding, however under the proposal the conditions and circumstances would be known soon after the first PD run and therefore excluded from consideration following a subsequent (confirming) PD run. Similarly, a trader who is alerted to a *possible* plant issue may wait until closer to the relevant interval to make sure the issue has in fact eventuated before making a rebid. Under the rules amended, the trader would need to rebid when first alerted to the issue, and rebid again if it does not eventuate. The inevitable effect of the proposed change would be to see an increase in the number of rebids (many of which might then need to be reversed).

Under this proposal, every participant would be required to comprehensively re-examine every piece of data in relation to their bid for all periods, following every change to published data, and rebid if they believe there is a material change, or lose the ability to make such a rebid regardless of whether a change is ultimately considered material. That is, a rebid would be considered to be in bad faith if there was no change in material conditions and circumstances between when a subsequent rebid *could* have occurred and when it *did* occur. While the Proponent may claim that this is not the intent of the change, it is the practical result of requiring rebids to be entered "*as soon as practicable after the change comes to its attention*" and be in response to *all known (conditions and) circumstances*.

- Assuming participants overcome the fear of "false positive" penalty application, this proposal will likely result in a large number of bids being altered at least each pre-dispatch run[26] which in turn are likely to become a material change in the subsequent pre-dispatch publication. As a result, rebids which will lead to material changes prompting further rebids, and this has been envisioned by the Proponent as a way to drive efficiency in the market Such a large volume of information changes could make pre-dispatch highly volatile and create significantly higher risk profiles for participants. It is highly unlikely that such rebidding behaviour – being driven by this proposal – would improve the transparency of the market or the accuracy of PD, nor would it be likely to improve the reliability of PD for demand side participation or peaking generation as intended by the Proponent. The NGF also considers such a situation to be impractical from a generator perspective. As an example, NGF member Hydro Tasmania would have to consider the current level and associated water inflow forecast against the previous forecast for each of its 73 water catchments and storages every time a rebid is made regardless of whether the initial material change affected any of these. It would create an

[26] Multiple bids could occur within a predispatch run if updated information was received from another source.

unnecessarily burdensome process that would take focus away from delivering efficient market outcomes and increase compliance and data management costs.

The NGF also wishes to draw attention to the practical implications of the proposed change in situations where a single update causes otherwise unrelated changes in strategy for two or more time periods – for example a profit maximising rebid in the short term and a constraint management rebid for the following day.

- Under current rules participants may submit separate rebids for each relevant time period with a rebid reason which is applicable to each change in isolation.
- This behaviour provides relatively simple correlation of the reason provided with the behaviour observed and enhances transparency in the market.
- Under the proposed change only one rebid could be entered as a second rebid would not have a material (or significant) change that had occurred since the prior rebid was entered.
- The rebid reason would accordingly need to reference both changes and is likely to become less clear – in the above scenario a rebid reason such as "14:54A PD14:45 increased sensitivities and constraint management" would be correct but would not identify which aspect of the rebid reason applies to which aspect of the rebid.
- The imminent ability to enter significantly longer rebid reasons may be overridden by the practical requirement to have the short term rebid submitted to the market in a timely fashion, or the extended field may remain insufficient.
- The NGF considers it would be more likely that the AER would request additional information in relation to this rebid than either of the more targeted individual rebids, increasing workload on both participants and the regulator.

While the concept of using a generator's whole portfolio to assess compliance is not explicitly covered by the issues paper, the NGF considers the two issues are intertwined. The NGF notes that some participants may use different bidding tools for different elements of their portfolio, may be required to submit rebids via joint venture parties or have other operational complexities which would not result in all bids within a portfolio being submitted on an entirely consistent basis. It would be inappropriate to create technical breaches in circumstances where the *intent* of the rebidding is appropriate, and the NGF considers that such a requirement would likely do so.

While this set of examples is not intended to be comprehensive, the NGF considers that it highlights that the proposal is inappropriate and unworkable.

Question 4b)

Do you consider the proposed rule to be practical and sufficiently clear as to when a generator must rebid following a change in material conditions and circumstances?
No.

The proposal to have rebids entered "as soon as practicable after the change comes to its attention" suffers from the same issues as discussed in response to 4a).

The NGF also consider that having such a subjective measure is likely to increase the number of "false positive" occurrences of bids which could not be "proven" to be in good faith. Cases revolving around when a change "came to the attention" of a trader are easy to envision.

The NGF considers that this aspect of the proposal is in direct opposition to the AER's *Rebidding and Technical Parameters Guideline.* Specifically the guidelines state that the information provided in the rebid reason should include "*the time the event occurred (**for the avoidance of doubt, this may not be the time at which the decision to make the rebid was made, nor the time the rebid was submitted to AEMO**, this is the time at which the relevant event(s) or occurrence(s) that the participant adduced as the reason for the rebid occurred)*"[27] (emphasis added).

There appears to be no rationale provided as to why the AER guidelines are considered incorrect, inappropriate or insufficient.

The NGF emphasises that it does not take issue with this proposed rule change simply for its lack of clarity. For the reasons set out above, any proposal that forces generators to rebid at or near the time of the relevant change is a dramatic change to the market design that could have serious consequences for price outcomes.

[27] AER *Rebidding and Technical Parameters Guideline* Page 11

Question 4c)

Do you consider that rebids should only be limited to the occurrence of a significant change in conditions and circumstances? If so, how would this be achieved in practice?

The NGF supports the current good faith bidding requirements which state that rebids must be in response to "a change in material conditions or circumstances". The existing Rules provide extensive investigation and information gathering powers to enable the AER to enforce the good faith provisions. The NGF also considers that the current rules achieve this in practice as evidenced by the extremely low proportion of rebids which require AER investigation and the extremely high proportion of such rebids that are resolved following a simple information request.

The proponent is concerned that *'if a wide interpretation of material conditions and circumstances is taken, there will be a large number of circumstances upon which the participant may rebid*'. While this may be true, it is simply a reflection of the fact that there are a large number of circumstances that will influence or underpin an offer or rebid submitted to the NEM. A change in any one of these parameters may justify a decision to rebid if it is 'material'.

The NGF considers that there is unlikely to be a difference between a "material" change and a "significant" change under the ordinary meaning of the terms. The NGF have been advised that most lawyers would regard these terms as having a similar meaning.

Indeed the NGF notes that Justice Dowsett used the definition of material contained in the Oxford English dictionary which includes the definition of "material" as "significant"
"material"
…
(chiefly in law) of evidence or a fact: ***significant*** *or influential, especially in having affected a person's decision-making;…* (emphasis added)[28]
…

The NGF also considers that a notionally small change or changes can be material or significant and quantifiable at certain times to certain generators under specific circumstances. Even a small change in underlying circumstances (eg expected demand) will be material if it affects the dispatch of a marginal generator. 'Materiality' is something that can only be assessed in knowledge of all the circumstances.

Similarly, although not addressed by any questions in the issues paper the NGF considers there to be no material difference between the current use of the composite phrase "conditions and circumstances" and the proposed use of "circumstances" under the "ordinary meaning" of such terms.

As neither proposed change appears to affect the (ordinary) interpretation of the clause they cannot be said to enhance the NEO and therefore are not supported by the NGF.

[28] AER vs Stanwell judgement [341]

Question 5

Do you consider it reasonable that all bids and rebids should be made with reference to published AEMO data.

No.

Markets are characterised as a competitive process between participants who each have their own view of the market. This view is informed by their own analysis of public and private data. This proposal implies that the only source of information should be from AEMO. Through forcing participants to consider only AEMO data, the proposal forces participants to adopt a very narrow view of the market which is to the detriment of market analysis, innovation and competitive advantage.

The NGF notes that the proposed rule change includes the provision "or other material change", however is concerned that the wording of the proposed change would bias interpretation inappropriately. The NGF believes this concern is supported by the AEMCs question which excludes consideration of "other material changes".

As is acknowledged by the AEMC, there may be generator specific factors that may prompt a rebid such as change in contract position or change in plant capabilities. Restricting such considerations as basis for a rebid would be highly detrimental to participants and in turn the NEM.

The proposal also makes no allowance for the consideration that the AEMO forecasts may be unreliable or based on information that is inconsistent with that which is available to specific participants[29].

Critically the Proponent also aims to exclude the non-fulfilment of trader's expectation from being considered a change for the purposes of 3.8.22A. This is entirely unacceptable. Traders are specialists whose informed opinions should be considered material.

- Even limiting consideration to AEMO published data, and assuming that the forecasts are very close to market outcomes prior to a rebid, a trader is likely to consider additional information such as sensitivity forecasts when formulating a rebid.
- If the sensitivity data shows that moving 100MW from one price band to another will change the dispatch price from $A to $B and the trader determines that such a change would be profitable (or meets whatever metric is guiding the decision) and that there is a relevant change, they will enter a rebid to do so.
- If after the rebid the price does not move to $B as forecast it implies that either there has been some other change that has superseded the original sensitivity forecast or the original sensitivity forecast was incorrect.
- Such an occurrence should not preclude the trader entering a further rebid, including a rebid that reverts to the original profile.
- In practice rebids rarely conform so neatly to AEMO data and require interpolation, extrapolation, estimation or incorporation of external data and opinions.

This last point goes to the heart of the rule change proposal. None of the behaviours described above are improper. In the NEM spot market, generators will make decisions, in good faith, to offer electricity into the market based on their expectations about what will happen, both as a result of their actions and a complex web of other factors. This is not an indicia of market power or manipulation, it simply the supply of a commodity into a competitive market. Generators are constrained by their competitors and their contract position from exercising market power in the

[29] Such information could include alternative weather information or modelling, controlled DSP etc.

generation market. The Proponent would seek to curtail this behaviour, on the assumption that it is resulting in prices that exceed efficient costs over the long run. The Proponent's case for change is not made out. The proposed rule change will produce costs in terms of efficiency and will not promote the achievement of the NEO.

Question 6a)

What are your views on the options discussed above? Do you consider any of these options or any other options around the design of the bidding process to better address the issues raised in the rule change request?

The NGF agrees that the options discussed are inferior to the status quo, as is the proposed rule change. The current process has worked well for over a decade and continues to see incremental improvements through measured, meaningful discussions between regulators and participants such as the AERs rebidding guidelines and compliance bulletin mentioned earlier.

The NGF are concerned however that regulators continue to find it appropriate to consider market design philosophies that provide preferential treatment to certain participant classes (option 1) or allow for reductions in wholesale prices but not increases (option 2).

Question 6b)

Are there any approaches used in electricity markets in jurisdictions overseas that could provide insight into the development of options to address issues raised in the rule change request?

The NGF considers that the current arrangements in the NEM strike a reasonable balance between certainty and flexibility and as such have not invested time and effort in such an investigation.

The NGF notes that the AEMC have referenced the Alberta MSA who considers that "*giving too much weight to short-term efficiency concerns can reduce the incentive to innovate or invest and may harm long-term efficiency*", and agrees with this sentiment.