



EnergyAustralia

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Dear Commissioners

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

Bidding in good faith consultation paper

EnergyAustralia welcomes the opportunity to make a submission on the 'bidding in good faith' rule change consultation paper (*the consultation paper*). We also thank the Commission for the opportunity to present at the public forum on this rule change¹.

EnergyAustralia is one of the country's leading retailers, providing gas and electricity to more than 2.7 million customers. We own and operate a range of generation and storage facilities, including coal, gas and wind assets, in NSW, Victoria and South Australia.

Dynamic bidding and rebidding is essential to efficient dispatch and risk management in the NEM.² The proposed rule change comprises three key elements that would severely restrict the ability to efficiently bid and rebid generation capacity in a timely manner:

- i. **Reverse onus of proof:** a trader is assumed to be guilty of an offence every time they bid or rebid unless they can prove otherwise.
- ii. **Threshold restrictions and burden of proof:** a trader must calculate and document, in real time, all 'material circumstances' and 'significant and quantifiable changes'.
- iii. **Professional judgement is restricted:** 'subjective judgement' is an essential trading skill, developed through experience that creates value.

We do not support the proposed change. The proposal would in effect systematically impugn the behaviour of all market participants and every individual trader. We encourage the Commission to consider the personal impact of a rule that declares every trader's bid to be an offence unless they can prove otherwise.

We take our responsibility to bid in good faith very seriously, and comply with the letter and spirit of the good faith provisions in the National Electricity Rules (NER). We understand that the AER was unable to substantiate a prosecution against one generator for breaching good

¹ The presentation is available on the AEMC website <http://www.aemc.gov.au/Rule-Changes/Bidding-in-Good-Faith>

² The ACCC rejected similar change in 2002 for this reason and the importance of rebidding is well summarised in the consultation paper on pages 14-15.

faith. However, this does not justify the imposition of substantially new and more restrictive obligations.

Assessment framework

We agree with assessment framework proposed by the Commission and note that:

- The problem or market failure has not been clearly identified or defined.
- There is no evidence of material issue and wholesale prices, volatility and future contract prices are all low.
- The proposed change is onerous and is disproportionate to the nature of any of the issues considered in the consultation paper.

As the consultation paper notes, in 2002 the ACCC “determined to allow rebidding with a condition of market monitoring that would assess the impact of rebidding activityand considered that the information accumulated through the market monitoring process would drive possible market reforms into the future.”³ With more than decade of information available no material problem has been identified.

Unnecessary and inefficient regulation creates real costs for participants and consumers. At a time when State and Federal Governments are placing a high priority on reducing the burden of inefficient regulation on society, we encourage the Commission to robustly test any proposed ‘solutions’ to ensure they would result in net benefits and preferentially seek options that improve the alignment of market incentives and reduce regulatory costs.

Reversal of the burden of Proof

In the context of legal proceedings the burden of proof rests with the AER to demonstrate, on the balance of probabilities, that the relevant trader did not have an intention that a bid be honoured for the Dispatch Interval to which it related at the time made, absent a change in material conditions and circumstances. This is appropriate.

In 2002 the ACCC concluded when considering a similar proposal that ‘the overall effect of such a proposal may be to deter new entry and legitimate rebidding, thus diminishing competition and exacerbating the problem it was intended to solve’.⁴ This logic is enduring and there is no rationale to revisit proposals to further restrict bidding.

It is appropriate to set a very high bar before considering reversing the burden proof for offences. No issue is raised in the consultation paper that would justify reversing the burden of proof. We note that in the context of the harmonisation of Occupational Health & Safety laws in 2012, the reverse onus of proof was removed where it was a feature of existing legislation, restoring the presumption of innocence.

We note that the Proposal also seeks to allow a Tribunal to conclude a contravention based on an inference regarding actual knowledge or belief, not only intention, notwithstanding the extent of the documentary evidence. In the end it will be for the judge, making a decision regarding the facts and the law, to decide whether or not to draw any such inference. The most useful evidence may be the trader’s state of mind given in oral evidence before a judge and their log entries, as it was in the Stanwell Case.⁵

³ ACCC, Amendments to the National Electricity Code – Changes to bidding and rebidding rules, 4 December 2002, pp.5-6.

⁴ Ibid, p21

⁵ AER v. Stanwell Corporation Limited [2011] FCA 991 para 351

Flexible, dynamic bidding supports an efficient market

The fundamentals of an efficient market have not changed since this issue was last reviewed. While the names of some of the institutions have changed, the observations of the NSW Ministry of Energy and Utilities in 2002 remain current:

- the vast majority of bids are beneficial and NECA and the ACCC must take care to avoid unintended consequences involved in any rule changes that attempt to restrict bidding behaviour, and
- non-regulatory alternatives needed to be looked at including structural solutions, interconnection and demand side response.⁶

We agree with the characterisation of the role and importance of rebidding to support efficient investment in, and operation of, the NEM. In a competitive market, it is essential that participants are free to respond to price signals in making their operational and investment decisions. Regulators should not seek to second guess these decisions.

It is important to note that scheduled generation provides the most transparent and reliable pre-dispatch information available to the market, and scheduled generators are already bound to make their bids in good faith.

There is likely to be greater scope to improve the information in pre-dispatch by enhancing AEMO's demand forecasting and the transparency of demand response. The consultation paper also identifies two other potential issues that may reduce dispatch efficiency: late strategic rebidding, and the inconsistency between five minute dispatch and thirty minute settlement.

These are interesting market design issues, and we support the principle that aligning market incentives to promote efficient behaviour should be preferred to blunt regulatory prohibitions. However these issues should be looked at in broader market reviews rather than joined to the consideration of this rule change. There is no need for the Commission to consider a 'preferable rule' as the case for change has not been made.

The proposal would increase costs and constrain efficient bidding

Rebidding is an iterative process that facilitates price discovery and allows participants to react in real time to changes in the market and their position. The proposal would severely constrain our ability to bid with confidence:

- Every trader is assumed to have contravened the rule every time they offer, bid or rebid unless they can prove otherwise.
- Every trader must calculate in real time all 'material circumstances' and 'significant and quantifiable changes' to avoid an adverse inference by the AER or Tribunal regarding not "only" their intention but also pursuant to the proposed amendment their actual knowledge and belief⁷.

⁶ ACCC, Pre-determination Conference Minutes, 13 August 2002 pp5-6.

⁷ AER v. Stanwell Corporation Limited [2011] FCA 991 para 346

"CI 3.8.22 does not focus upon individual conditions or circumstances. Rather it prescribes an examination of the totality of relevant conditions and circumstances upon which a rebid is based, with a view to seeing whether or not there has been any change in that overall combination. Use of the words "conditions and circumstances" suggests that such examination includes the whole "scenario" in which the rebid was made, to the extent that it is known and relevant to the rebid. Such an approach is rational, but it poses difficulties in addressing questions of good faith. It cannot sensibly be expected that in making a particular rebid a trader would examine every item of data available at that point in time. Some aspects of the data may be substantially stable, not varying to any great extent or frequently. Such data would become a subconscious part of the rebidding process, and would probably only be consciously addressed if there were substantial and/or unusual changes in it. Other data may change frequently and/or unpredictably.

- Every trading team and trader must document each and every offer and rebid to a standard that will stand up to later judicial scrutiny, regardless of the state of the market.
- Professional 'subjective' judgement is an essential trading skill, developed through experience that creates value through anticipating and reacting to a very complex market environment.

It is important to emphasise that the good faith penalties apply to the individual trader as well as the company. The proposal would impose unconscionable stress on individual traders and the trading team.

The requirement to track, quantify and document 'all material circumstances' that went into the original offer and any rebids for the unit they are re-bidding and across the portfolio is not practical.

The proposal would increase costs and risk for generators and reduce market efficiency:

- Responding to revealed market changes will be more difficult.
- Responding to anticipated changes before they occur will be almost impossible.
- Compliance costs will increase exponentially.
- The ability to attract and retain skilled people will be compromised.

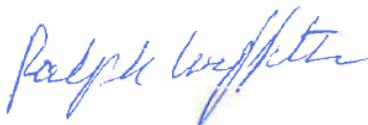
Given the million dollar fine combined with the proposed changes, the prudent generator or trader is compelled to consider implementing increased oversight and full audit capability and data capture on market and bidding systems, just in case a specific bid or rebid is challenged.

Conclusion

We do not support the proposed changes. A material issue has not been identified and the nature and cost of the proposed changes is completely disproportionate to the issues discussed. A response to the specific questions raised in the consultation paper is attached.

For any questions regarding this submission, please contact me on (03)86281034.

Regards



Ralph Griffiths

Wholesale Regulation Manager

Response to questions in the consultation paper

1. Do you consider late strategic rebidding to be the primary issue raised by the rule change?

No. The primary rationale for the rule change appears to be that the AER was unable to substantiate a prosecution against a generator for breaching good faith. The proposal is structured to restrict rebidding in all circumstances and allow the regulator to determine what an appropriate bidding strategy for a generator is.

If late strategic bidding is the primary issue, then the proposed change is disproportionate and poorly targeted. It would apply to all bids and rebids, even hours before the dispatch interval.

The rule change proponent suggests that generators have an incentive to strategically rebid very close to the dispatch interval to limit time for other supply or demand side participants to react. The materiality of this is questionable given the transitory and unpredictable nature of the circumstances that allow a generator to successfully execute such a strategy.

A dispatch interval is only five minutes, and participants bid on 288 intervals every day. This constant repetition provides an opportunity for other participants to understand, anticipate and respond to strategic behaviour. Ironically, the proposed rule change would constrain the ability for traders to use their subjective knowledge to anticipate and respond to another participant's strategic behaviour.

There must always be a gate time, it can be moved forward or back but cannot be removed. Bringing the gate period forward by restricting the ability to rebid close to a dispatch interval would reduce efficiency by restricting the ability of generators to react to changes in demand and other circumstances in real time.

Additional restrictions on generation would exacerbate the asymmetry with demand response. Demand response can also be dispatched strategically, potentially by the same traders that bid generation; however no scheduling or good faith obligations apply to demand.

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 bidding? Do you have any views as to how any issues arising could be addressed?

The averaging of price across six dispatch intervals for each thirty minute settlement period creates different incentives at the margin than would exist if dispatch and settlement periods were aligned. However, it is not obvious that this inherently benefits one group over another. If both periods were aligned at five minutes, it would still be difficult to respond to five minute price changes and it is likely that different behaviours would emerge.

This is an interesting market design issue, but it should not be reviewed in the context of this rule change proposal.

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

No. The measure is disproportionate and poorly targeted to the issues raised.

Dynamic bidding and rebidding is essential to efficient dispatch and risk management in the NEM.⁸ The proposed change would severely constrain the ability of participants to bid efficiently whilst creating significant compliance costs and uncertainty.

4. a) Do you consider that all known conditions and circumstances should be taken into account in generator bids and rebids?

This is not the appropriate question. Of course participants will seek to take into account all known circumstances when making their bids and rebids.

However, this is not the same as quantifying and documenting all material circumstances, and any changes, to the standard that would be needed to prove good faith to a court under the proposed reverse onus of proof.

Competent and experienced traders should be free to include their subjective judgements in their analysis of the circumstances. The proposed change seeks to constrain this important role.

- b) 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, it is impractical. The use of the expressions such as 'as soon as practicable after the change comes to its attention' and 'change in material conditions and circumstances' are both open to different interpretations by the trader, generator, AEMO and the AER in particular circumstances. Traders should be free to exercise their professional judgement on the basis of conditions and experience within the limits of their authority.

- c) 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?

No, this is impractical and inefficient. The judgement of what is material should rest with the individual participant and trader. The use of the expressions such as 'as soon as practicable after the change comes to its attention' and 'change in material conditions and circumstances' are both open to different interpretations by the trader, generator, AEMO and the AER in particular circumstances.

As the consultation paper observes, a material change may arise from the collective impact of multiple smaller changes that occur over various timeframes. It is often not practical to identify exactly which event was the tipping point and thus at what time it occurred.

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

No, it is not reasonable or efficient to limit bids by reference only to data published by AEMO.

AEMO demand forecasts and other pre-dispatch information is often not the best source to estimate what will actually occur. Analysis of weather forecasts and past patterns of demand can often provide a more accurate forecast of actual demand than pre-dispatch.

⁸ The ACCC rejected similar change in 2002 for this reason and the importance of rebidding is well summarised in the consultation paper on pages 14-15.

Participants should be free to develop their own view on likely outcomes and their own judgement.

6. a) What are your views on any of 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?

We do not support the proposed changes. A material issue has not been identified and the nature and cost of the proposed changes is disproportionate to the issues discussed.

Each of the options proposed would introduce new inefficiencies. They have been rejected before for good reasons and there is no rationale to consider them again.

- Disallow rebidding within three trading intervals prior to dispatch (1.5 hours): we agree with the previous analysis of the ACCC that this would just create additional inefficient costs and risks. There is still a gate closure and someone makes the last bid; however the ability to efficiently respond to real time changes in weather, demand and generation is severely impeded.
- Only allow rebidding that has the effect of depressing spot prices: this rests on the false premise that low prices are always desirable or efficient. Artificially constraining prices leads to over consumption and under production. Again we agree with the ACCC's previous rejection of this proposal.
- Only allow rebidding for bona fide technical reasons: this constrains the ability for supply to efficiently adjust to all market circumstances. Again the ACCC was correct to reject previously.

- b) 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?

We do not accept that this rule change raises issues that need to be addressed.