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FOR A BETTER WORLD

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Attention:

Mr John Pierce
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Australian Energy Markets Commission

Level 6, 201 Elizabeth Street

Sydney NSW 2000

Lodgment via: AEMC Web page

REF CODE: ERC0166

19th June 2015

Dear Commissioners,

Re: Submission – AEMC Draft Determination - Bidding in Good Faith Rule Change Proposal

Visy acknowledges the Commission's Draft Determination with respect to the South Australian Government's rule change proposal on good faith bidding in the National Electricity Market. We welcome the opportunity to provide our views on this matter of vital importance to the electricity-consuming sector of Eastern Australia.

Please find our submission attached.

Yours sincerely,

(Royce DeSousa)

General Manager - Energy & Sustainability, Visy Industries Australia

Introduction

As Visy has maintained in prior submissions to the AEMC on the SA Government's rule change proposal on good faith bidding in the NEM, spot outcomes over the last 3 years in Queensland have reinforced serious flaws in the National Electricity Rules (NER) which allow market participants to engage in bidding behaviour with damaging effects for electricity consumers and for confidence in the market – late strategic rebidding is one key phenomenon.

Late strategic rebidding

The AEMC has clearly identified that the phenomenon of late rebidding ***is*** occurring - that is, that in particular markets (notably QLD and SA in recent times) over particular periods, there has been a strong correlation between high-priced rebids and last dispatch intervals. AEMC is not alone in its assessment – this phenomenon has also been pointed to by market regulator, AER in its State of the Market 2014 Report, market operator AEMO, as well as a number of independent consultants who have conducted work as part of the AEMC's rule change proposal review.

Visy has also seen a very strong correlation between high priced rebids and late dispatch intervals in the last years in Queensland[1] which is too strong, statistically, to be explained away as a random outcome – in Visy's view concerted strategies implemented by a very few market participants in Queensland to rebid volume at high prices are highly likely to have had the intent of preventing competitive response by others – it is difficult to conceive of another rational explanation for this statistically-significant phenomenon.

As the AEMC has pointed out in its Draft Determination[2], some participants have been able to: "*disproportionately influence price outcomes close to dispatch*" through the practice of late strategic rebidding and "*it is the inability of certain participants [other generators and wholesale and other consumers] to respond in time that drives most of the impacts of late rebidding*"

Perhaps somewhat predictably, some, but not all generators, appear to claim that the late rebidding phenomenon does not exist – this position is very difficult to accept as fact, as it runs totally counter to the unanimous position of 3 independent and unbiased government agencies covering policy, regulation and market operation, not to mention independent expert consultants to the AEMC which have formed similar views.

In short, late strategic rebidding (a term coined by the AEMC) is occurring, exacting damaging outcomes on the market and on the whole electricity-consuming economy in affected states, in an environment of

[1] See Visy's February 2015 submission to the AEMC Options Paper on the Bidding in Good Faith Rule Change Proposal presenting data demonstrating skewness of extreme spot prices in QLD towards the last dispatch interval from 2013 to the date of the submission – no further data is included in this report however the underlying trend demonstrated in the Feb-15 submission continues to the date of this submission.

[2] AEMC Draft Rule Determination – National Electricity Amendment (Bidding in Good Faith) Rule 2015 (16th April 2015) p.45

surplus generating capacity - under the current NER, there is no reason to believe that such activity may abate or that it will not commence in regions other than QLD and SA in the future.

To accept the rhetoric of many market participants that there is simply no problem with late strategic bidding or similar anti-competitive behaviour is to accept future market outcomes in the NEM dictated unilaterally by large, powerful entities who have successfully engaged in this form of bidding behaviour without restriction.

Far from inviting new entrants into the market, late strategic rebidding is a powerful message to intending entrants, such as fast start peaking generators, that if they choose to enter the market, they may not be able to use their investment to actually respond to high prices in time.

In Visy's view, if confidence is to be maintained in the NEM, material reform to the NER must occur to prevent late rebidding, other than rebidding that has a legitimate reason and is not anti-competitive in nature.

Other forms of bidding not in good faith

While late strategic rebidding has featured prominently recently, the NEM is prone to other forms of bidding which are not in good faith and maybe anti-competitive in nature – as an example the AER pointed to abuse by some generators of generous "ramp rate" requirements in its recent rule change proposal. It is important that bidding behaviour that is generally not in good faith, is properly targeted by changes to the NER to restore integrity of outcomes in the NEM.

Behavioural Statement of Conduct – Good Faith bidding rule

Visy strongly supports the intent behind the AEMC's proposal to replace the current provisions requiring generators to 'bid in good faith' with more targeted provisions proscribing against making offers or bids that are false or misleading or likely to mislead. Subject to some refinement, Visy also supports the detail of the provisions proposed by the AEMC.

Rather than employing a common definition of the term good faith, the existing Rules enshrine a very specific meaning of the term which has a far narrower reach than the common meaning of the term. Additionally, in the case of *Stanwell*[3] the court looked at the trader's intent, solely from the perspective of the trader, as the basis of determining whether a change in circumstance had occurred. This resulted in a highly *subjective* test of whether the rebidding activity was in good faith and the effect of this judgment was to heavily dilute the circumstances prohibited by the good faith provisions and to make it difficult for a *change in material conditions and circumstances* of this type to be verified with corroborating evidence. Unfortunately the 'band aid' adjustments to the good faith rules suggested by the SA Govt in its rule change proposal would not have been sufficient to ameliorate these fundamentally and demonstrably ineffectual provisions.

[3] *Australian Energy Regulator v Stanwell Corporation Limited (2011)*

Behavioural Statement of Conduct – AEMC proposal

AEMC proposed false and misleading bids and offers provisions

Subject to some alteration to ensure there are no 'grey areas' in determining what is false or misleading, the new provisions proposed by the AEMC as its more preferable rule change are certainly welcome as they provide a more objective test and are likely to be more effective in stamping out bidding behaviour which is not in good faith in a common sense, thereby largely aligning with the original intent behind the existing good faith provisions. Additionally, it is Visy's view that these suggested rules would be far less prone to judicial interpretation which may fatally distort the original intent behind the provisions as occurred in *Stanwell*.

Inclusive rather than exclusive definition

An improvement on the existing good faith bidding rule, the AEMC proposal that bids, offers and rebids not be false, misleading or likely to mislead provides an *inclusive* definition rather than an *exclusive* definition of those terms[4] - that is, whilst criteria are provided to determine what a *false* or *misleading* rebid might be under clause 3.8.22A(b)[5], a market participant may still be found to have lodged a false or misleading bid even if those specific criteria are not fulfilled[6].

Secondly, the term *likely to mislead* is not defined with reference to specific criteria and therefore has the character of a purely *objective* test with a common meaning.

False or misleading by inference

As the AEMC has explained in its Draft Determination[7] the intent behind the proposed provisions is that whether a rebid is false or misleading can be determined not just with reference to the rebidding participants conduct but by reference to the knowledge and conduct of any other person and other extrinsic factor – this is a significant improvement on existing provisions – in *Stanwell*, the bona fides of the rebid was assessed based on the trader's intent and in a vacuum without extrinsic information being considered.

Reference by court to new Market Design Principle

[4] The current definition of a bid, offer or rebid being made in good faith is an *exclusive* definition with very narrow criteria which limits the coverage of this clause

[5] The criteria are: (a) no genuine intention to honour the rebid, and (b) does not have a reasonable basis to represent to other participants that it will honour the rebid, if the material conditions and circumstances on which the rebid are made remain unchanged

[6] The general requirement not to make false or misleading bids under cl.3.8.22A(a) is not exclusively defined by criteria in cl.3.8.22A(b)

[7] AEMC Draft Rule Determination – National Electricity Amendment (Bidding in Good Faith) Rule 2015 (16th April 2015) p.42

The new provisions require any court considering an action under the false and misleading bidding provision to have reference to the new "*market design principle*" set out in clause 3.1.4(a)(2) of the NER which requires the provision of:

> "*accurate, reliable and timely forecast information to Market Participants, in order to allow for response that reflect underlying conditions of supply and demand*"

This addition is important as it provides an objective test for a court to apply in determining whether the participants rebid was accurate and reliable as well as whether the rebid was intended or likely to inhibit response from other participants reflecting the underlying conditions of the market – this would prevent judicial decisions around intent being made in a vacuum as to market objectives, as seems to have been the case in *Stanwell*.

Suggested alteration – Proposed Rule 3.8.22A(b)

Visy notes that the *false and misleading* criteria in Clauses 3.8.22A(b)(1) [having an *intention* not to honour a bid or rebid] and 3.8.22A(b)(2) [not having a *reasonable basis to represent* to other participants that the participant will honour the bid or rebid] need to be co-incident for a false and misleading conclusion to be drawn under 3.8.22A(b). That is, not only must a participant not have had a reasonable basis to represent to other participants that it would honour its bid (an objective test) but it also must not have had the intent to honour the bid (a subjective test). As co-incident conditions, the latter, subjective requirement therefore renders the former, objective test, redundant.

Visy suggests splitting these requirements such that a false or misleading conclusion can be drawn on either a subjective intent not to honour the bid or an objective inability to represent that a bid would be honoured.

This would require the 'and' linkage between 3.8.22A(b)(1) and (2) to be replaced with an 'or' linkage.

Alteration required – *change in material conditions and circumstances* requirement – Proposed Rule 3.8.22A(b)

Visy is concerned that the change in 'material conditions and circumstances' requirement appears to have carried over from the good faith provisions and is still susceptible to misinterpretation as a term having potentially extremely broad meaning.

Visy provides three examples of reasons provided by participants which may be said to be 'material conditions and circumstances' in one sense but which may still not point to the bona fides of the rebid in terms of its possibly anti-competitive nature or intent – these are actual reasons provided in the past for rebids in Queensland where volume was bid from lower price bands to higher price bands,[8]:

1. AEMO's 5-minute pre-dispatch demand forecast is higher than its prior 30-minute pre-dispatch forecast

[8] Visy can provide examples of such rebids where requested by the AEMC

2. The generator plant of a participant other than the participant making the rebid, has failed unexpectedly reducing the output of that generating plant
3. AEMO's 5-minute pre-dispatch price forecast is higher than its 30 minute pre-dispatch price forecast

While the above changes in *conditions and circumstances* may possibly be *material*, they are not circumstances directly related to the participant actually making the rebid - in assessing these actual past rebid reasons after the events to which they related, Visy, and other observers, concluded that the changes in material circumstances referred were significant *increases in the market power of the rebidding participant* (due for example to a prior shortfall in forecast demand or the failure of a competitor generator) – Visy and other observers surmise, for example, that in the first example above, the shortfall in AEMO demand forecasting close to dispatch significantly increased the rebidding participant's market power which provided the impetus for it to shift capacity to higher price bands and be dispatched at those higher levels – in essence, and without evidence to the contrary, Visy assessed the reasons to amount to a temporary increase in market power prompting the participant to rebid capacity into higher price bands.

Visy's point here is that the reasons provided in these cases may have said to have been a change in material conditions and circumstances – these may possibly go towards the intention of a generator to honour its rebid, but may not necessarily be legitimate in terms of anti-competitive intent or effect.

Separately, the above examples illustrate that it's possible for a very broad range of other circumstances and conditions to be considered material, whether or not they point to the bona fides of the rebid.

Visy is not at this stage able to offer a robust alternative to the *material conditions and circumstances* term but strongly counsels the AEMC to be wary of the potential holes in this definition through which anti-competitive conduct could slip.

Conclusion – AEMC behavioural statement of conduct

Broadly speaking, the AEMC proposed false and misleading rule change certainly improves the ability of the NER to mitigate against rebidding behaviour which is not in good faith. However, Visy believes there are some aspects of the proposed rule that need tightening to ensure that forms of conduct which are anti-competitive in nature and intent, do not circumvent the application of the rule.

Rebidding restrictions and reporting requirements – AEMC Proposal

AEMC More preferable rule proposal

In seeking to eliminate late strategic rebidding, the AEMC has proposed in its more preferable rule 3.8.22 that reports be made by participants to the AER where participant rebids are made within 15 minutes (3 Dispatch Intervals) of the approaching Trading Interval, explaining the reasons underpinning

the rebids and the change in material circumstances giving rise to the rebid. This particular rule would not prohibit any specific rebids. Exceptions could be granted to some participants from time to time.

Effectiveness of a reporting-only requirement

Visy certainly strongly supports the motivation to specifically deal with questionable late rebidding however Visy is about the likely *effectiveness* of the AEMC's proposal in tackling and preventing late strategic rebidding.

Firstly, as identified above, proposed clause 3.8.22 only imposes a requirement to report on reasons for the rebid but does not prohibit any rebids. This means that, apart from the change in material circumstances requirement, any reason can be provided by a participant under clause 3.8.22 and it is only under the false and misleading bidding provision, clause 3.8.22A, that the acceptability of the reason can be assessed.

The AEMC has considered in its Draft Determination that the requirement to issue a detailed report is in itself a disincentive to lodge illegitimate rebids – Visy is not convinced that this will be sufficient to mitigate against questionable rebidding behaviour. Visy would note that rebid reasons are already required under the current NER and it is likely that participants are already keeping more detailed records as to their reasoning – Visy points to rebid reasons ending "SL" meaning "see log" where, presumably, the participants own private records may contain more information as to the circumstances and reasoning behind the rebid – the AER currently has powers to interrogate this information.

Material conditions and circumstances requirement

Secondly, as highlighted in the section above entitled *"Alteration required – change in material conditions and circumstances requirement – Proposed Rule 3.8.22A(b)"* it is questionable how meaningful the *material conditions and circumstances* criterion is in terms of the bona fides of the rebid and whether the rebid is anti-competitive in nature or intent.

Therefore this reporting requirement suffers from the same "material conditions and circumstances" shortcoming as the false and misleading provisions.

Reporting requirement - administrative burden and exemptions

While some participants have complained that the administrative requirement to report on all rebids would be a burden, Visy is not convinced. As canvassed above, the *existing* rules require reasons to be provided for all rebids although the detail required is less. As noted previously though, many generators are likely already to be keeping record of intent and conditions underpinning their rebids as the "see log" example points to.

If generators are frequently making rebids of a very similar type and of similar intent that is legitimate and not contrary to the NER objectives, the generator will likely to be able to issue reports very similar in content in all of these instances thus significantly reducing the administrative burden.

Visy notes the AEMC's proposal that the AER may exempt certain parties from the detailed reporting requirement and this could alleviate concern for those consistently engaging in proper bidding behaviour. If concern remains for some participants, the AEMC could consider an exemption from reporting for rebids not involving rebid of volume to a higher price band above a nominal amount (for example $300/MWh), while requiring the abbreviated reporting prescribed under the current rules.

On the other hand, there should be no sympathy for the requirement to issue detailed reporting where observers have reason to question the intent behind the rebid.

AER content of reports

Visy believes more clarity is needed on the likely content of reporting to be determined by the AER as this will be crucial in determining the success of these provisions in stamping out questionable bidding behaviour.

Conclusion – Rebidding detailed reporting requirement

In principle, Visy supports the requirement for additional reporting for rebids after a designated timeframe, so-called "soft gate closure", subject to judicious exemptions to prevent administrative burden. However, it is also wary of the ability of this initiative to decisively stamp out questionable rebids. Consequently, Visy believes that a "moderate gate closure" approach – one involving the prohibition of rebids after a designated timeframe but subject to legitimate exceptions – must be applied.

Rebidding Restrictions – Gate Closure

As indicated above, a reporting requirement on its own is insufficient in Visy's view to stamp out questionable rebidding activity.

Visy believes that gate closure prohibiting rebidding after a designated NEM timeframe is instead necessary to properly address late strategic rebidding, whilst prudent exceptions will prevent legitimate late rebidding from being unfairly targeted.

Gate Closure Timeframe

Visy in its February submission to the AEMC on this issue[9] proposed a 30-minute time frame (see submission for specific details).

This was based on a reasonable timeframe for response by leading edge fast-start generation and industrial electricity curtailment capability.

Visy is willing to concede a contraction in the timeframe, in general terms to 15 minutes prior to the next Trading Interval but as spelt out in detail in the AEMC's Draft Determination (linked to its reporting proposal)

[9] Visy's February 2015 submission to the AEMC Options Paper on the Bidding in Good Faith Rule Change Proposal

Exceptions

There should be legitimate exceptions to the prohibition on rebidding as Visy spelt out in its February 2015 submission. Broadly these exceptions are (a) of a physical nature relating to plant failure or system security / safety, and (b) rebids that result in a downward revision in price bid.

Visy spelt out those exceptions as follows in its Feb-15 submission:

1. Physical exceptions – system security, safety, plant failure
    a) Necessary for safety, environment or system security
        - It is necessary for the generator to rebid in order to mitigate potential or actual negative impact on NEM system security, safety to personnel, material negative impact to environment
        - Whether the rebid was in fact necessary for safety or environment must meet an objective test
        - As noted by the AEMC, consideration should be given to whether generators should be able to adjust their bids at other generating units within their portfolios in these instances – it may well be that that a generating entity may need to manage its wholesale risk and potentially contractual risks by compensating with other units and so such an allowance may well be appropriate, provided that the necessity to do so is clearly linked back to an objectively identified serious safety, environment or system security risk
    b) Unplanned / forced outage due only to technical fault or safety or environment
        - An outage has been forced by (a) a technical fault of the generating plant or (b) actual or threatened impact to safety of personnel or environment by maintaining the standing bid
2. Volume bid within a higher price band maybe revised to be bid within a lower price band
        - By nature, lowering the price of an offer does not normally impair competition since competition from suppliers will tend to lower prices (all other things being equal)

As part of the granting of these exceptions, the participant would need to be able to demonstrate to the AER that the actual reason matches the reason above, but only if the AER decides at its discretion that the participant need provide information to demonstrate that these reasons applied to the participant in the relevant instance – this would prevent unnecessary routing reporting. The AER would need powers allowing it to obtain information to demonstrate the veracity of the participant's claimed reasons in instances chosen for scrutiny by the AER.

In addition, Visy suggests a further exception to cover cases that are not covered by the above exceptions but nonetheless may constitute legitimate rebids from the perspective of intent and the impact on competition:

3. Rebids for other reasons where:
    a) the participant demonstrates to the AER that its reasons are:

i. not anti-competitive in effect or in intent
ii. not contrary to the NER objectives generally,
iii. not contrary to the NER market design principle in the AEMC's proposed Rule 3.1.4(a)(2),
iv. not contrary to the Object and provisions of the *Competition and Consumer Act (Cth) 2010*, and

b) the AER has full powers to garner evidence to determine that the reasons were not contrary to the requirements above

Visy notes, as it has in prior submissions, that many forms of late rebidding are likely to be legitimate and these should not be inhibited lest market efficiency is impacted and participants generally lose confidence in the market to support their participation. Exceptions 1 and 2 above go specifically to this principle and exception 3 recognises that it is not possible to anticipate all possible legitimate exceptions. This will alleviate any concerns raised by participants and stakeholders to date that gate closure will jeopardise legitimate rebidding behaviour and market efficiency.

Having said this and as detailed above, the participant not meeting exceptions 1 and 2 above needs to provide much more detailed reasoning to demonstrate, to the satisfaction of the AER, that its bid did in fact have a reason which was in (a) good faith and (b) did not have anti-competitive nature or intent – as to the latter, the requirement to comply with the Object and provisions of the *Competition and Consumer Act (Cth) 2010*, although implied at present, is crucial.

Visy recognises that these exceptions could be said to almost amount to the AEMC's proposal of "soft gate closure" whereby rebids can occur with reporting, however, Visy believes that its suggestion of applying a general prohibition on rebidding and allowing rebidding only by (a) specifically prescribed exceptions relating to plant, safety or lowering of price, or (b) unprescribed exceptions where a high level of scrutiny is applied to the reasoning underpinning the rebid, is a quite different approach which will shine a strong spotlight on questionable behaviour and prevent it from being "lost in the wash" with the majority of legitimate rebids.

Visy's suggestion is that participant bidding entries post the gate closure period be automatically "locked out" by AEMO systems requiring the participant to "actively unlock" its rebidding by either nominating specific exceptions 1 or 2 noted above or by nominating general exception 3, triggering a downstream detailed reporting requirement with AER.

AEMO Market Clearing Engine and System Changes

Visy recognises that there may be considerable effort and possibly not immaterial cost associated with the prohibition on rebidding required to be made in AEMO's systems. However, Visy believes these difficulties and costs will be modest in the context of losses to market efficiency and damaging market outcomes that have been caused to date and will be caused in the future by questionable late rebidding.

International context

What was borne out in the research on international markets conducted for AEMC by a reputed independent expert is that it is an inescapable fact that the NEM stands out as a jurisdiction with an energy-only market with an extreme market price cap and **no gate closure**.

Participants arguing against any hard gate closure are arguing against the premise of the vast bulk of successfully functioning energy-only markets around the world and it is difficult to attach weight to these claims in an international context.

Conclusions – Rebidding Restrictions and Reporting

While Visy strongly supports the sentiment of the AEMC's proposed reporting requirement to target illegitimate late rebidding, Visy believes that a reporting-only requirement will be ineffectual in attempting to stamp out this behaviour.

Visy's strong view is that a stronger approach is needed to be effective – this must involve a general prohibition on rebidding within the designated timeframe, effected in AEMO systems, subject only to specific plant failure, safety or price-lowering exceptions or a general exception requiring detailed reporting to the AER demonstrating that the rebid was not anti-competitive in nature or intent and was made in good faith (as detailed in Exception 3, earlier in this submission).

Additionally, by allowing specific legitimate exceptions of safety, security, plant failure and price-lowering bids, reporting burden claimed by some participants in response to the AEMC's draft determination would be alleviated