



Critique of Bidding in Good Faith Second Draft Rule Determination

A REPORT PREPARED FOR CS ENERGY

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Critique of Bidding in Good Faith Second Draft Rule Determination

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Executive summary

Frontier Economics has prepared this report for CS Energy in response to the AEMC's Second Draft Rule Determination (SDRD) on the bidding in good faith Rule change proposed by the South Australian Minister for Mineral Resources and Energy.

The AEMC's draft Rule would amend the National Electricity Rules by:

- Replacing the current requirement that generation offers be made in good faith with a prohibition again making false or misleading offers.
- Imposing an obligation on participants to ensure that any variations to offers be made as soon as practicable after a change in material circumstances and conditions.
- Imposing an obligation on participants to record information for variations to offers made close to dispatch.

The AEMC's SDRD makes a number of assertions regarding the economic harm said to arise from so-called 'deliberate late rebidding'. However, the SDRD does not explicitly define the term 'deliberate late rebidding' and provides no evidence that it occurs or has occurred in practice. Unless and until the Commission can clearly explain what it means by 'deliberate late rebidding' and how its estimates of economic harm can be attributed specifically to 'deliberate late rebidding' and not to rebidding close to dispatch more generally (that is, rebidding following a change in material circumstances, without delay, even where this occurs close to the start of the interval), any claims regarding economic harm from deliberate late rebidding have to be considered speculative.

Even if the Commission could clearly identify historical instances of behaviour it considers constitutes 'deliberate late rebidding', there does not appear to be any sustainable distinction between deliberate late rebidding (as described by the Commission and which the Commission disapproves of) and the exercise of transient market power (which the Commission does not appear to disapprove of).

The AEMC's SDRD refers to two separate pieces of analysis prepared by its consultants. In both cases, the authors were at pains to stress that they have identified correlations and do not make any claims as to causation. Notwithstanding the caution shown by its consultants, the AEMC in the SDRD drew a number of unwarranted causal inferences about the effect of 'deliberate late rebidding' on contract price outcomes. The fundamental problem with the empirical estimates prepared by the AEMC's consultants is that it assumes – for no clear or robust reason and despite self-described evidence to the contrary – that a reduction in price volatility in late dispatch intervals would not result in an offsetting increase in price or volatility in earlier dispatch intervals. The estimates

also suffer from various flaws that are likely to systematically over-estimate any harm resulting from deliberate late rebidding – assuming it exists at all – and underestimate the costs of addressing it.

In our view, the wording of the draft Rule embodies a number of serious flaws. It is inconsistent with good regulatory practice for these flaws to be left unresolved. The key flaws we consider the draft Rule embodies are as follows:

- The wording of the draft Rule obligation on participants to rebid ‘as soon as practicable’ appears to contradict the AEMC’s stated intent in its SDRD.
- The requirement for a court to have regard to wider market objectives in assessing whether rebids have been made ‘as soon as practicable’ goes against logic and is inappropriate.
- The ability for the AER or a court to find a bid false or misleading even where the participant genuinely intended to honour that bid at the time it was made and had the capacity to do so.
- The new record-keeping obligations under the draft Rule reinforce our concerns regarding the impossibility of complying with the obligation to rebid as soon as practicable.

Even if these flaws could be addressed, the draft Rule is likely to have a number of perverse incentives that may harm the efficiency of market outcomes. These include:

- Deterring efficient rebidding close to dispatch even where it helps to increase low-priced supply and reduce spot prices. Generators may fear that the AER will query why any late increase in low-priced supply did not occur earlier.
- Encouraging ‘unwieldy rebids’ – participants may not be able to rebid only in respect of an approaching trading interval because to do so could imply that they did not rebid as soon as practicable in respect of later trading intervals.
- Imposing high administrative burdens. Traders are likely to be advised by their firms’ compliance departments to devote much more time to focusing on these matters, diverting them from bidding their plant in a manner most responsive to market conditions.

Finally, if the draft Rule is amended to overcome the issues we have raised, or operates in a different manner than that explained by the AEMC, it may have little effect on bidding behaviour despite retaining most of its costs of compliance.

Executive summary

1 Introduction

Frontier Economics (Frontier) has prepared this report for CS Energy in response to the Australian Energy Market Commission's (AEMC's) Second Draft Rule Determination of 17 September 2015 (SDRD) on the bidding in good faith Rule change proposed by the South Australian Minister for Mineral Resources and Energy. Although the report has been prepared for CS Energy, it is the view of Frontier Economics and should be referenced as such in any Final Determination.

The AEMC's proposed draft Rule would amend the relevant provisions of the National Electricity Rules (NER) as follows:¹

- The current requirement that generation offers be made in good faith would be replaced by a prohibition against making false or misleading offers.
- An obligation would be imposed on participants to ensure that any variations to offers be made as soon as practicable after a change in material circumstances and conditions.
- An obligation would be imposed on participants to record information for variations to offers made close to dispatch.

This report examines both:

- The AEMC's assessment of 'economic harm' from deliberately delayed rebidding as described in the Second Draft Rule Determination (section 2) and
- Whether the AEMC's proposed draft Rule would be likely to improve economic efficiency and promote the National Electricity Objective (NEO) (section 3).

Our conclusions are set out in section 4.

¹ SDRD, p.i.

2 Economic harm from late rebidding

2.1 Meaning of deliberately late rebidding

The AEMC's SDRD makes a number of assertions regarding the economic harm said to arise from so-called 'deliberate late rebidding'. Before commencing our analysis of the AEMC's quantitative estimates of economic harm, it is worth exploring what the Commission appears to mean by 'deliberate late rebidding'.²

The SDRD does not explicitly define the term 'deliberate late rebidding'. However, the SDRD makes clear that rebidding close to dispatch *per se* need not be harmful and will not be proscribed, because:³

Rebidding by participants, including rebids made very close to the time of dispatch, is a necessary component of the market. Rebidding provides generators with the flexibility to adjust their positions to accommodate changes in market conditions and to respond to the offers or bids of other participants.

Later in the SDRD, the AEMC acknowledges that it is rational for participants to bid – deliberately, we presume – as late as possible:⁴

Generally, as time moves towards the point of dispatch, the amount and accuracy of information upon which the generator can assess the probability of any particular event increases. Information available to the generator increases over time and becomes a maximum at the point of dispatch, where by definition, the occurrence or non-occurrence of any given event becomes a certainty. As a consequence, a generator has an incentive to wait until the last possible moment to make a rebid because that is when the greatest amount of information is likely to be available upon which it can make a decision on its final market position.

Yet throughout most of the SDRD, the AEMC refers to 'deliberate late rebidding' in a pejorative sense, as if it means something different to the behaviour it appears to approve of in the above passage.

The AEMC does not directly differentiate between desirable deliberate late rebidding and undesirable deliberate late rebidding. However, the SDRD does indirectly identify the form of late rebidding it seeks to limit by focusing on its misleading and information-withholding character.

² In this context, we note that empirical analysis by CS Energy previously submitted to the AEMC found that the average 'delay' between the event or circumstance cited in a rebid and the rebid itself over the summer of 2014 and 2014-15 was only 3 minutes.. See *CS Energy response to Bidding in Good Faith: AEMC Draft Determination*, 11 June 2015, p.9.

³ SDRD, p.ii.

⁴ SDRD, p.13.

For example:⁵

However, problems arise when deliberately late rebids are systematically used by some participants to withhold information from the market.

And further:⁶

Late rebids are not in themselves misleading as to a generator's intentions. However, it could be suggested that the generator's previous offers or rebids could become misleading during the interval between the generator's change of intention for dispatch and its late rebid...

Unfortunately, neither the AEMC nor its consultants attempted to assess whether actual historical instances of rebidding close to dispatch:

- could be attributed to genuine (and recent) changes in market conditions – and were therefore understandable and even desirable; or
- reflected an attempt to mislead other participants (by delaying a rebid that should have been made earlier) – and were therefore undesirable.

Likewise, the AEMC does not cite any specific examples or provide any clear evidence that misleading and undesirable rebidding close to dispatch occurs or has ever occurred in the NEM. Yet it is through its consultants' analysis of historical rebidding close to dispatch that the Commission has derived its estimates of the economic harm of 'deliberate late rebidding'. Unless and until the Commission can clearly explain how its estimates of economic harm can be attributed specifically to undesirable and misleading late rebidding (of the kind described in the second bullet point above) and not to rebidding close to dispatch more generally, any claims regarding economic harm from deliberate late rebidding have to be considered speculative.

2.2 Types of economic harm

The SDRD refers to a number of types of economic harm resulting from 'deliberate late rebidding':⁷

- Imperfect competition between generators: This appears to mean that some participants may be able to 'skew' outcomes to those more favourable to themselves. However, the significance of such outcomes for overall economic welfare is not clearly explained.
- Inefficient price signals for consumption and production: This appears to refer to increases in the cost of dispatch (due to uneconomic start-up) and

⁵ SDRD, p.ii.

⁶ SDRD, p.51.

⁷ SDRD, pp.20-23.

the allocative inefficiency caused by prices that are higher than they otherwise would be.

- Inefficient price signals for investment: The AEMC refers to the potential for fast-start generators to adjust their operating regimes or invest in improvements to plant flexibility in ways that they would not do in the absence of deliberate late rebidding.
- Contract market distortions: The AEMC contends that deliberate late rebidding increases contract prices and premiums.
- Increased uncertainty: To the extent deliberate late rebidding causes price volatility, the AEMC contends that it could deter efficient provision of Demand Side Management (DSM) or efficient consumption or investments by customers, even if the anticipated volatility does not occur.

As discussed above, it is difficult to respond to the Commission's outline of the types of economic harm attributable to 'deliberate late rebidding' without knowing precisely the form of behaviour the Commission has in mind, how it differs from non-misleading and desirable rebidding close to dispatch and its empirical prevalence.

Late rebidding and transient market power

The SDRD is careful to distinguish between what it refers to 'deliberate late rebidding' and the exercise of transient pricing power. The SDRD states:⁸

The Commission considers that transient pricing power should only be of concern if it occurs frequently enough and to a sufficient magnitude that average prices are sustained above new entrant LRMC for a period of time. However, the Commission does not consider that this definition of transient pricing power can be applied to late rebidding.

The reason that average prices are compared against LRMC is to measure the extent to which a new entrant could cover its costs and incur a profit upon investment. Substantial market power is deemed to occur if this price signal for investment exists but barriers to entry prevent the new investment from taking place.

However, the price impacts from late rebidding cannot be considered as an efficient price signal for investment because they can have the effect of precluding the occurrence of a competitive demand or supply side response in the short term. Despite the high market prices, investment in new fast-response plant or demand-side activities are not likely to be economic, as they would not be able to react to the short timeframes involved and respond to the short term prices created through late rebidding.

Alternatively, if a fast-response plant could be built to respond to the prices created through late rebids, it is likely to be an inefficient investment due to the higher costs involved in building to meet the short response timeframes.

⁸ SDRD, pp.30-31.

Unfortunately, this passage does not explain why the Commission should consider price spikes due to ‘deliberate late rebidding’ – even assuming such behaviour existed – to be less harmful than price spikes caused by transient pricing power. Both forms of behaviour would presumably be engaged in to increase a participant’s expected profits. And both forms of behaviour could lead to a degree of inefficiency in dispatch, consumption and investment outcomes. Qualitatively-speaking, there is no difference between ‘deliberate late rebidding’ and the exercise of transient market power: Both forms of behaviour seek to take advantage of situations where a generator is ‘pivotal’ (necessary for meeting demand and therefore has the ability to increase price significantly above marginal cost). Transient market power simply operates on a slightly longer – but still relatively short – timeframe than ‘deliberate late rebidding’. This is only a difference of degree, not a difference in the fundamental character of the two types of behaviour.

However, policy-makers and courts have traditionally been reluctant to intervene in markets due to the occasional or transient exercise of market power, because the costs of doing so are thought to outweigh any benefits. This is because it is ultimately not possible to prevent the exercise of transient market power without imposing highly prescriptive and intrusive obligations on participants to the point where the NEM no longer operates as a ‘bid-based, self-scheduling’ market. We see no reason why this same reluctance to impose prescriptive and intrusive obligations should not extend to the AEMC’s position in modifying the NER to proscribe ‘deliberate late rebidding’.

Policy-makers’ and courts’ decisions to not intervene in response to potential instances of transient market power is, in our view, grounded in the view that, left alone, workably competitive markets will respond to such events:

- short term rebidding of in-service plant
- increased supply by starting fast start gas and hydro units
- utilisation of DSM
- changes to risk preferences leading to altered contracting behaviours, and
- new investment in fast start capacity.

While in the short term, there may be limited ability to respond to the exercise of transient market power or ‘deliberate late rebidding’ (even if it exists), by definition this is not a permanent state of affairs. To the extent that ‘deliberate late rebidding’ may have been pursued by a participant in order to increase profits, it would have been a function of the participant’s contracting level. This, in turn, would have reflected not only the participant’s own risk preference, but also those of its actual and potential contractual counterparties. Put another way, retailers may in aggregate decide to carry a level of hedge cover that creates or increases incentives for participants to engage in ‘deliberate late rebidding’, just as

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it increases the opportunity for transient market power to be exercised. To the extent that this aggregate outcome across both generators and retailers leads to higher prices and a perception by retailers of greater risk in the market, a likely response would be to carry a higher level of contract cover in future, schedule more fuel for a gas turbine or coal fired unit, shorten outages, increase plant reliability and thereby changing the market-wide equilibrium and potentially reducing the extent to which transient market power and/or ‘deliberate late rebidding’ would be profitable in the future. Ultimately, every participant needs to make an assessment of the extent to which they choose to be exposed to high prices – whether due to the exercise of transient market power or ‘deliberate late rebidding’.

The ability of the market to respond means that regulatory intervention is unlikely to achieve material incremental benefits in terms of increased efficiency but may impose significant direct or indirect costs.

2.3 SDRD estimates of economic harm

The AEMC’s SDRD refers to two separate pieces of analysis:

- ROAM Consulting report showing correlation between late rebidding and spot prices⁹
- EY report showing correlation between spot prices and ASX-traded contract prices¹⁰

In both cases, the authors¹¹ were at pains to stress that they have identified correlations and do not make any claims as to causation. For example, ROAM pointed out that:¹²

The analysis above indicates that rebidding, and particularly late rebidding, has strong relationships with both high pool prices and a response to forecast high pool prices. These relationships only suggest that the variables are correlated and cannot determine whether there is any causal relationship between rebidding and price outcomes.

Further studies could be conducted that examine the impact of an earlier gate closure over the historical period. It should be acknowledged however that this backcasting would rely on the assumption that bidding before gate closure did not change from the historical observations, whereas if a longer gate closure was in effect in the market then generation may behave differently. Generational portfolios may simply move their ‘late’ rebidding to the last minute before gate closure and

⁹ ROAM Consulting, *Analysis of rebidding activity in the NEM*, 17 October 2014 (ROAM report).

¹⁰ EY, *Impact of late rebidding on the contract market*, 11 September 2015 (EY report).

¹¹ EY acquired ROAM during the period between the publication of these two reports and the reports reflect shared authorship.

¹² ROAM report, p.46.

thereby still restricting the ability of other participants to respond. Such behaviour may remove any perceived benefit of an earlier gate closure.

While the AEMC has not proposed earlier gate closure in the SDRD, the same principle of participants modifying their behaviour around market rule changes requirements in ways that seek to achieve similar outcomes applies to any predictions made by the AEMC in respect of its draft Rule change.

EY made several similar comments to those made by ROAM, including:¹³

It is important to recognize that this does not necessarily provide evidence that quarters with a high volume of late rebidding are causing contract prices to increase. Rather, this shows that there is often a positive correlation – this correlation may result from the interaction of late rebidding with other variables such as demand, changes in the generation portfolio, etc. that in turn, impact wholesale market prices and therefore contract prices.

And:¹⁴

The key challenge in testing the effect of late rebidding on wholesale and contract markets is identifying whether wholesale market outcomes are caused by late rebidding. The statistical analysis conducted is not appropriate for identifying this causal relationship. Even sophisticated backcasting techniques that could be applied to determine the impact of historical strategic late rebidding on wholesale prices would be underpinned by the assumption that removing strategic late rebidding does not affect other bidding behaviour.¹⁵

Therefore, although the statistical analysis shows that there may be relationships between late rebidding and price volatility and/or increases in contract market prices, this does not provide that eliminating or reducing strategic late rebidding would negate these outcomes.

Notwithstanding the caution shown by its consultants, the AEMC in the SDRD drew a number of inferences about the effect of late rebidding on contract price outcomes. The AEMC suggested that:¹⁶

As an order of magnitude assessment, ***deliberate late rebidding is estimated to have added a premium of eight dollars to the price of caps Queensland in the final quarter of 2014, and seven dollars in the first quarter of 2015.*** Overall, the additional expenditure on ASX traded caps and base futures ***caused by deliberate late rebidding*** over this time period has been estimated at \$103.8 million. This does not include impacts on other hedge products, such as options, or bilateral transactions on the OTC market. Therefore, ***the total magnitude of impact*** may be substantially higher than this value. Ernst & Young has suggested an assumption of 60 percent of Queensland contracts traded through ASX energy, meaning that once

¹³ EY report, p.17

¹⁴ EY report, p.21.

¹⁵ We disagree with this point. Backcasting could be conducted that explicitly accounted for strategic response, for example using game theory as in Frontier Economics' SPARK model.

¹⁶ SDRD, p.24.

OTC trades are taken into account, the total magnitude of the impact would increase to approximately \$173 million. [Emphasis added]

These assertions go well beyond what ROAM and EY were prepared to observe in their findings. If the AEMC has conducted further analysis that establishes causation, then it should report that analysis. We discuss the statistical relationships established by ROAM/EY and the AEMC interpretation of these results in the following subsections.

2.3.1 Correlation versus causation

As discussed above, ROAM Consulting and EY repeatedly stated that their analyses focused on establishing correlation rather than causation. The analyses identified correlations between both rebidding and late rebidding (variously defined) and other variables including the dispatch interval within a trading interval in which the rebid occurred, demand conditions, outage conditions, interconnector headroom, spot prices and contract prices.

We believe these analyses overlook two key factors:

1. The level of prices and price volatility in the NEM at the times that receive most scrutiny (Queensland in 2014 and South Australia in 2013)¹⁷ are not outliers when considered within the long term history of the NEM.
2. Establishing a correlation between variables, for example frequency of rebidding and spot prices, is likely to provide relatively little insight into market outcomes in most instances. This is because, as ROAM's study shows in part, many of the variables considered are likely to share the same fundamental causes and so correlation should be expected rather than seen as evidence of distortionary and harmful bidding strategies.

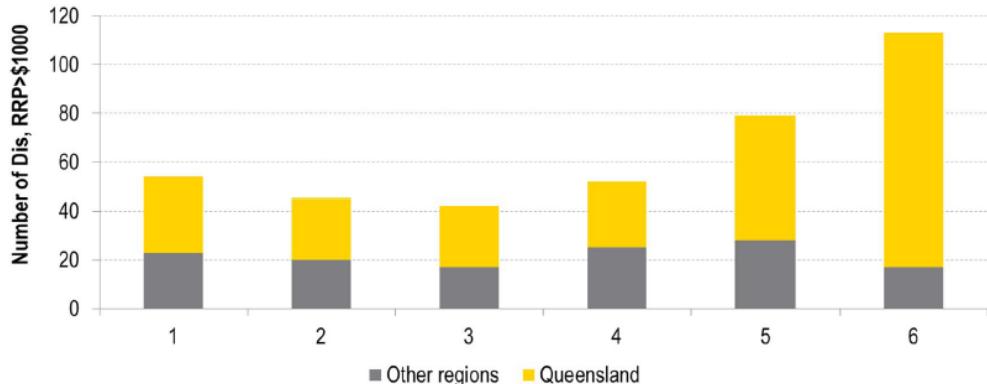
Historical price volatility

Since its commencement in late 1999, the NEM has encountered a wide range of market conditions. Throughout the 2000s, rapid peak demand growth against a backdrop of increasing drought led to tight supply-demand conditions and resulted in a high spot price levels and increased volatility. Figure 1 reproduces EY's chart showing increased price volatility (defined as the frequency of prices greater than \$1000/MWh) in Queensland since the start of 2014 by dispatch interval. This chart suggests an outsize level of volatility in Queensland relative to the rest of the NEM and a bias towards high prices in dispatch intervals five and six.

¹⁷ EY, p6.

Figure 1: EY, frequency of prices greater than \$1000/MWh, Queensland 1 January 2014 to 30 June 2015

Figure 8: Price Volatility since 1 January 2014



Source: EY report, Figure 8.

Figure 2 and Figure 3 show longer term pool price outcome for the four major regions of the NEM. Average annual prices are shown for the period 2006/07 to 2014/15 inclusive where the annual average price has been decomposed into the level of half-hourly prices across the year. For example, in NSW for 2006/07, half-hourly prices greater than \$1000/MWh (grey bar) contributed roughly \$11/MWh to the annual average price. Dashed lines are shown to aid comparison of 2014/15 levels to previous years. Both 2012/13 and 2013/14 reflect carbon prices.

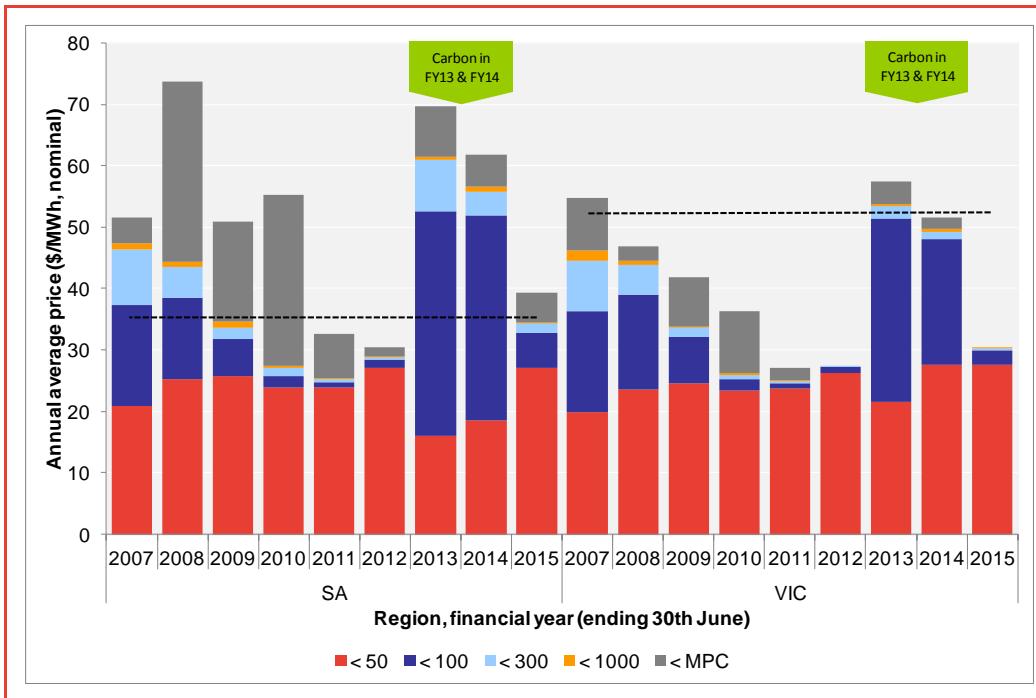
These figures provide context for the high price events seen in Queensland since 2014. Looking through the impact of the carbon price, both the level of prices and volatility of prices have been generally low across the NEM throughout this decade.

South Australia has seen much higher levels of prices and volatility in the 2007/08 to 2009/10 period, where half-hourly prices greater than \$1000/MWh added to \$15-30/MWh to the annual average price, relative to recent times. This is consistent with reduced demand across the NEM since 2010 and incremental wind investment in South Australia in particular.

In Queensland, again looking through carbon price impacts, whilst 2014/15 has included a relatively high level of both prices and volatility, market outcomes are consistent with both 2006/07 and 2007/08. Outcomes in 2013/14 could be fairly described as benign when compared to a longer historical baseline of outcomes in the state.

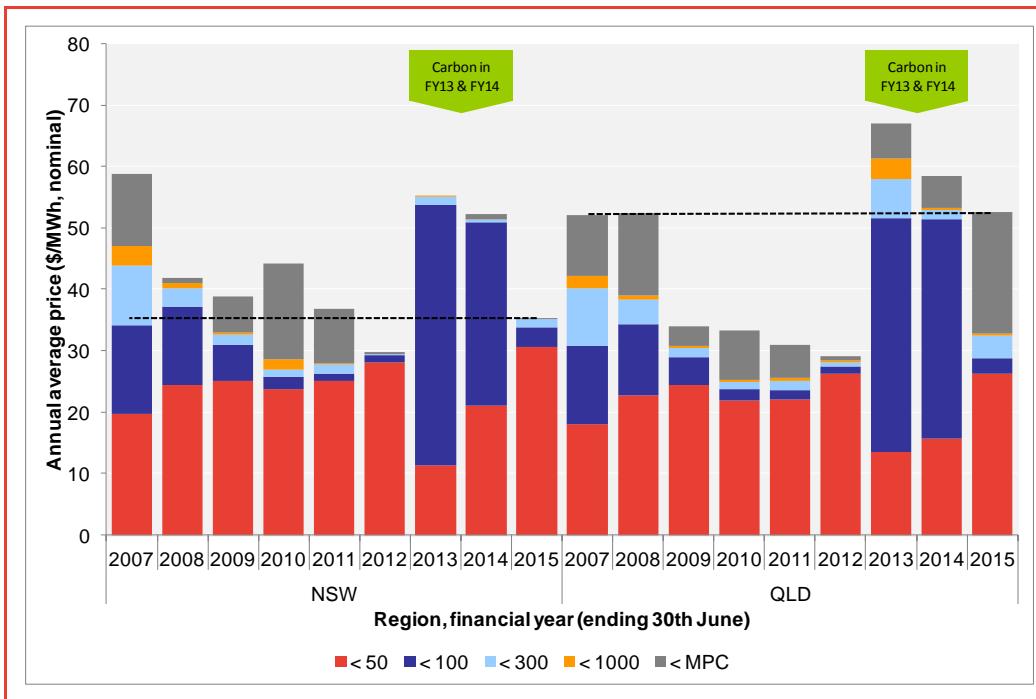
Economic harm from late rebidding

Figure 2: Annual average prices by price band – Southern regions



Source: Frontier Economics analysis of AEMO data

Figure 3: Annual average prices by price band – Northern regions



Source: Frontier Economics analysis of AEMO data

Economic harm from late rebidding

The NEM responded to conditions in the late 2000s in a relatively efficient manner without material intervention. It seems reasonable to suggest that the market is also capable of dealing with recent levels of volatility without intervention.

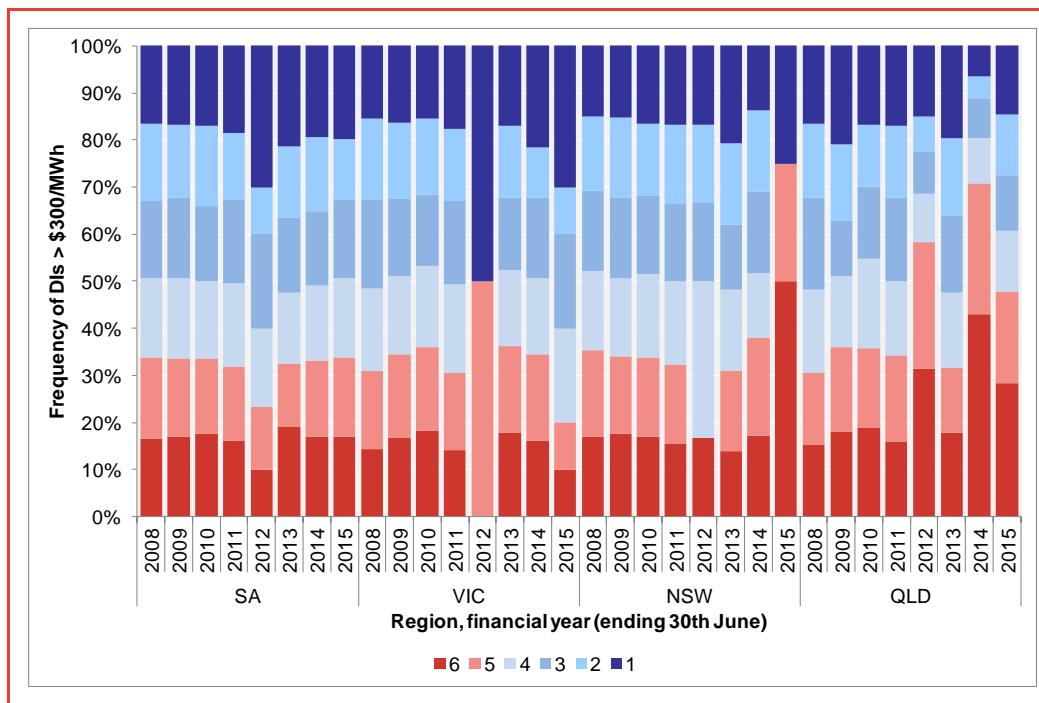
With regard to the correlation of high prices to specific dispatch intervals, Figure 4 shows the spread of dispatch interval number for all dispatch intervals with prices greater than \$300/MWh, where dispatch intervals five and six are shaded red to aid comparison. While there is some evidence of over-representation of dispatch intervals five and six in high price events in Queensland, we would make the following points:

- Whilst DIs five and six stand out for Queensland in 2013/14 they are exceeded in NSW in 2014/15 (across a low number of events) and, perhaps more importantly, similar to outcomes in Queensland in 2011/12. We are not aware of the AEMC voicing particular concerns regarding outcomes in Queensland in 2011/12; however outcomes then appear to be similar to those in recent years that are now receiving attention.
- Other regions see over-representation of specific DIs from time to time. For example, Victoria in 2011/12 for DIs one and five and in 2014/15 for DI one, NSW in 2011/12 for DI four and in 2014/15 for DIs five and six, SA in 2011/12 for DI one, etc. Again these correlations are not seen as issues in the SDRD and related analyses.

Moreover, we note that high-priced DI outcomes in Queensland have reverted to a much more even spread across DIs in 2014/15 than in the previous year. Combined with the seemingly random variations occurring in other regions, this is consistent with the notion that late DI high price outcomes in Queensland in 2013/14 were a transient phenomenon that will not recur systematically in the future. In that case, it is difficult to see the utility of the proposed Rule change.

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Figure 4: Spread of dispatch interval prices greater than \$300/MWh by DI number



Source: Frontier Economics analysis of AEMO data

Expected correlations

Many of the correlations established by ROAM and EY, for example frequency of rebidding and spot prices, would be expected in a workably competitive market. For example, if tight supply-demand conditions lead to both an increase in rebidding and higher spot prices, then this would cause a correlation between rebidding and spot prices. This is implicit in the fact that some of the strongest correlations reported by ROAM were when market fundamentals (demand or interconnector headroom) were compared to rebidding frequency.¹⁸

Figure 5 presents a scatter plot of all dispatch interval prices against a reserve margin ratio calculated as the sum of maximum availability¹⁹ within a region divided by regional demand and ignoring interconnectors from 1 January 2014 to 30 June 2015. This reserve margin provides a measure of capacity that is able to respond in very short time spans (as it relates to units in service). A reserve margin ratio of 1.0 indicates that maximum availability as bid is equal to demand. Prices for dispatch intervals five and six are shown in red to aid comparison.

Figure 5 shows a strong correlation between supply-demand conditions and dispatch interval prices. Also shown are a higher number of high price events in

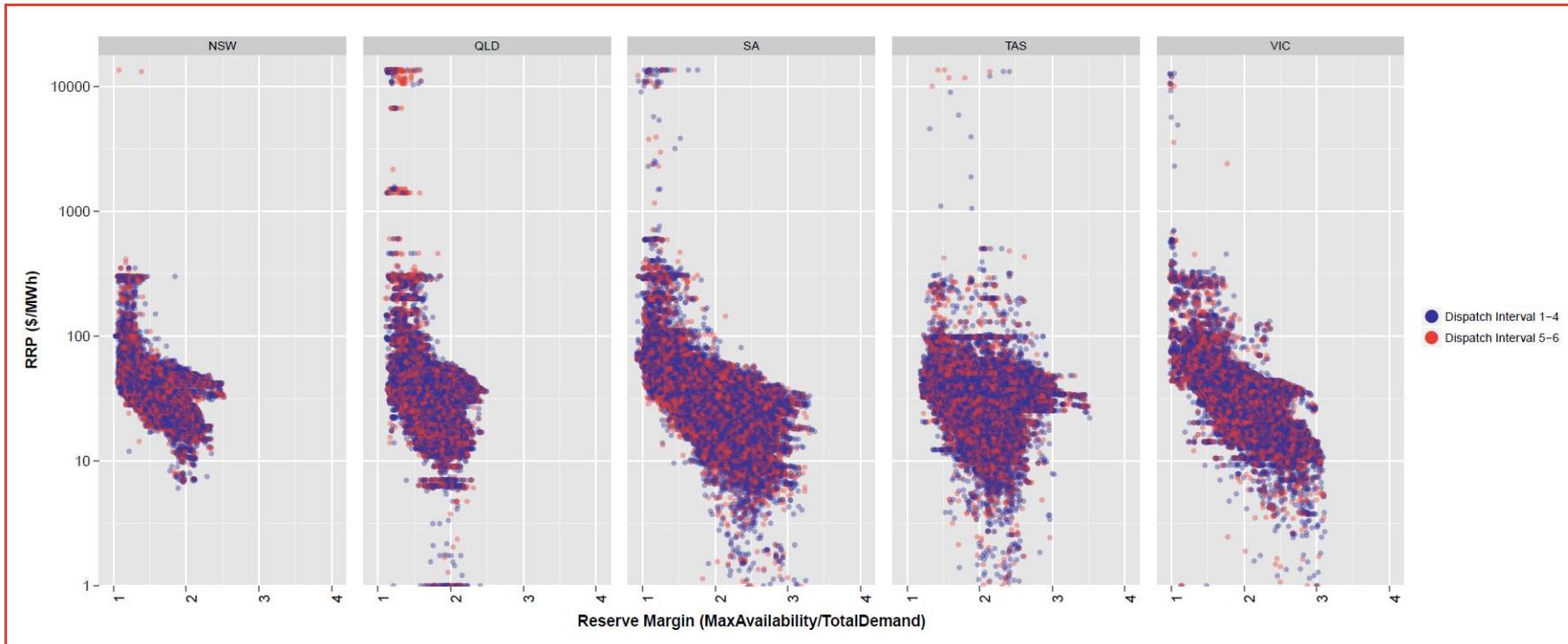
¹⁸ EY report, sections 6.2 and 6.3.

¹⁹ Maximum availability is defined as the sum of volumes bid as MAXAVAIL via AEMO's bidding process; no filtering of any kind has been applied.

South Australia and Queensland relative to Victoria and NSW. Outcomes in Queensland over this period also show the highest level of high price events in dispatch intervals five and six, consistent with Figure 4.

Figure 6 shows outcomes for each financial year just for Queensland. Again this chart demonstrates that previous years have been more volatile in terms of frequency of high price events.

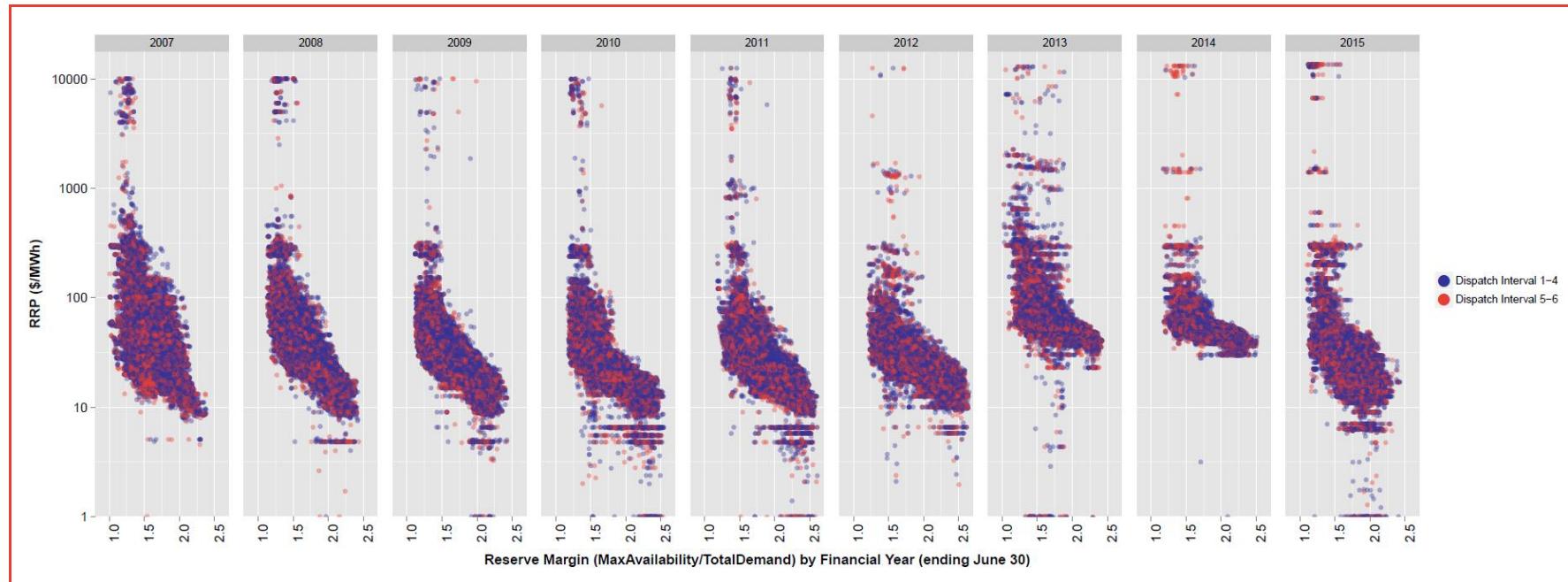
Figure 5: Reserve margin versus DI prices by DI number – 1 January 2014 to 30 June 2015 inclusive, all regions



Source: Frontier Economics analysis of AEMO data

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Figure 6: Reserve margin versus DI prices by DI number – 1 January 2007 to 30 June 2015 inclusive, Queensland



Source: Frontier Economics analysis of AEMO data

Economic harm from late rebidding

2.3.2 AEMC's methodology for estimating economic harm

The AEMC's SDRD arrived at an estimate of additional expenditure related to late rebidding for 2014 Q4 and 2015 Q1 of \$173 million. There are two broad issues with this estimate.

First, the methodology used to arrive at this number ensures that what is measured is a transfer between market participants, not an economic cost. We submit that economic costs and benefits should be the primary metric when assessing the level of efficiency (or lack thereof) in the NEM. Given that these outcomes reflect a very small number of events, it is unlikely that they are associated with material economic costs because:

- From a dispatch efficiency perspective, out-of-merit-order dispatch would be limited and highly transient.
- From an allocative efficiency perspective, retailers have a range of options open to them to limit the flow-through of price spikes to retail tariffs. This should limit any reduction in consumption due to slightly higher tariffs.
- From a dynamic efficiency perspective, with wholesale prices in Queensland and elsewhere presently well below any reasonable estimate of long-run marginal cost, it is unlikely that slightly higher wholesale prices than otherwise would induce materially inefficient investment decisions by actual or prospective consumers or producers of electricity.

Accordingly, it is difficult to imagine that material allocative and dynamic inefficiencies would result from such transfers.

Second, the final figure of \$173 million rests on a sequence of assumptions that, in our opinion, lead to an overestimation of additional expenditure. These assumptions are discussed below in the context of our analysis of the EY report.

2.4 Flaws with EY's methodology

2.4.1 Estimation of the spot price impact of 'strategic late rebidding'

EY explained how they inferred the impact of what they refer to as 'strategic late rebidding'²⁰ on wholesale spot prices as follows:²¹

²⁰ The terms 'strategic late rebidding', 'late rebidding' and 'deliberate late rebidding' have been used interchangeably at times by the AEMC and its consultants. At different junctures of this Rule change process the behaviour terms have been used to describe has also changed.

²¹ EY report, p.21.

[An earlier section] showed the increasing trend in recent year [sic] in Queensland of price volatility occurring late in the trading interval. Prior to 2012, a similar number of “price spikes” tended to occur in each dispatch interval of the trading interval. Since that time however, the bias towards volatility occurring during the latter part of the trading interval has increased...

[EY’s first methodology (Methodology A)] is based on the assumption that the increased likelihood of price volatility in the 5th and 6th dispatch intervals is the result of a change in generator behaviour during the trading interval. We have therefore applied a methodology that assumes the additional price volatility that occurs in these dispatch intervals (in comparison with the level of volatility in the first four dispatch intervals) is the results of strategic late rebidding. This assumption is used to determine the reduction in price volatility that may have occurred had strategic late rebidding not occurred.

This passage highlights several problems with EY’s approach to estimating the impact of what they call ‘strategic late rebidding’ on spot market outcomes.

First, EY’s approach inappropriately assumed complete independence between DIs: EY themselves observed that price volatility in Queensland had mainly *shifted* between DIs in recent years rather than *increased* overall. Yet despite this finding, EY considered it was appropriate to adopt an estimation methodology that assumed any reduction in volatility during the fifth and sixth DIs could and would not simply revert to earlier DIs. Without a robust theory as to how or why price volatility that had shifted from earlier DIs to later DIs would not simply shift back, it is unclear what value EY’s results have.

Under its second methodology (Methodology B), EY assumed that volatility in DIs five and six was 111% of that in the first four DIs.²² It is not clear how this substitution rule was then applied. EY themselves raised caveats with this approach,²³ most notably that it is a static analysis that does not account for changes in bidding behaviour across the market.

Further, we noted above that neither the AEMC nor its consultants attempted to assess whether actual historical instances of rebidding close to dispatch could be attributed to genuine changes in market conditions or reflected an attempt to mislead other participants. In the absence of any evidence demonstrating that historical instances of rebidding close to dispatch have been predominantly motivated by misleading other participants, it is inappropriate to refer to EY’s analysis as casting light on the impact of *strategic* late rebidding. Rather, it may be that the historical instances of rebidding close to dispatch reflected changes in market conditions or subjective expectations about market conditions.

Even if we were to assume (consistent with the intent behind the AEMC’s determination) that actual rebidding close to dispatch reflects a mix of changes in

²² EY report, Table 16.

²³ EY report, p.22.

market conditions and strategic behaviour, the estimated impact of strategic late rebidding on spot prices would be correspondingly less than estimated by EY.

In this context, we note and agree with EY's comment that it is the *cumulative* incidence of pool price spikes over a significant period of time (such as a quarter) that affects contract prices, not the incidence over a short period (such as a week):²⁴

There is relatively limited evidence that the market expectation of price volatility is sensitive to price volatility in the short term (e.g. less than a week). Rather, the cumulative impact of price volatility over longer periods, such as during the quarter, is likely to be a factor that influences the market's expectations of future volatility and therefore contract prices.

An implication of this finding is that if observed spot price volatility was only partly due to strategic late rebidding, it may be that, on its own, price volatility due to strategic late rebidding would not be sufficient to materially affect contract prices, because that part (if it existed) may have been too short in duration.

2.4.2 Non-ASX trade

The AEMC's final figure of \$173 million grosses up EY's estimate of \$103.8 million for ASX trade, assuming ASX trade represents only 60% of the total contract market. In our view, this has the potential to overestimate total expenditure.

2.4.3 Selection bias

The estimate is based on the sum of 2014 Q4 and 2015 Q1. This is the only period considered in which two consecutive quarters result in a material impact. Had the previous 2013/14 summer been chosen, only 2014 Q1 would have been included and the ASX impact would have been \$38.4 million. Grossing this up to estimate total trade in the manner undertaken by the AEMC would yield \$64 million. This is less than half of the numbers quoted in the SDRD.

2.4.4 Expenditure only

The \$173 million figure is an estimate of additional expenditure and is primarily a transfer between market participants, not an economic cost. However, there are likely to be material costs to the implementing the SDRD, some which may be true economic costs and some which may be transfers. These fall into two broad categories:

- **Direct costs.** Primarily compliance and any other costs associated with implementing the new rules.

²⁴ EY report, p.21.

- **Indirect costs.** To the extent that the revised rules reduce efficient rebidding and/or result in inefficiencies via reductions in the veracity of price dispatch forecasts these could impose economic costs.

2.5 Summary

There are a number of areas where the justification for the economic harm estimates cited in the SDRD and its supporting analysis appears to misrepresent the nature of the problem, presents transfers as economic costs and is likely to materially overestimate additional expenditure associated with 'deliberate late rebidding'.

Had the AEMC focused on the 2013/14 summer as opposed to the 2014/15 period, estimated additional expenditure would more than halve.

More generally, as noted above, in the absence of a clear framework for distinguishing between 'deliberate late rebidding' and bidding close to dispatch more generally, any claims regarding economic harm from deliberate late rebidding have to be considered speculative.

3 Economic efficiency and NEO implications

This section provides our assessment of the economic efficiency implications of the AEMC's proposed draft Rule and our view as to whether it is likely to promote the NEO.

Our approach to assessing the draft Rule involves considering:

- The rationale for the draft Rule: What is the perceived problem the draft Rule change is designed to address?
- The key obligations imposed on participants under the draft Rule: Does the draft Rule clearly reflect the AEMC's intent as expressed in the SDRD and are the obligations created by the draft Rule workable and logical?
- The likely effect of the draft Rule: How would the draft Rule influence participant behaviour and would this affect NEM outcomes in a way consistent with the NEO?

3.1 Rationale for the draft Rule

As discussed above, the ultimate problem the AEMC perceives as arising under the current market design is the economic inefficiency that is said to result from deliberately late generator rebidding behaviour. Leaving aside the question of whether this inefficiency actually arises and its magnitude, we understand that the AEMC believes the inefficiency would not arise if deliberately late rebidding did not occur.

Under the existing clause 3.8.22 of the NER, generators are free to rebid at any time up to the relevant dispatch interval. Any rebid must be accompanied by:

- “a brief, verifiable and specific reason for the rebid” and
- a note of the time the event or occurrence adduced as the reason for the rebid occurred.

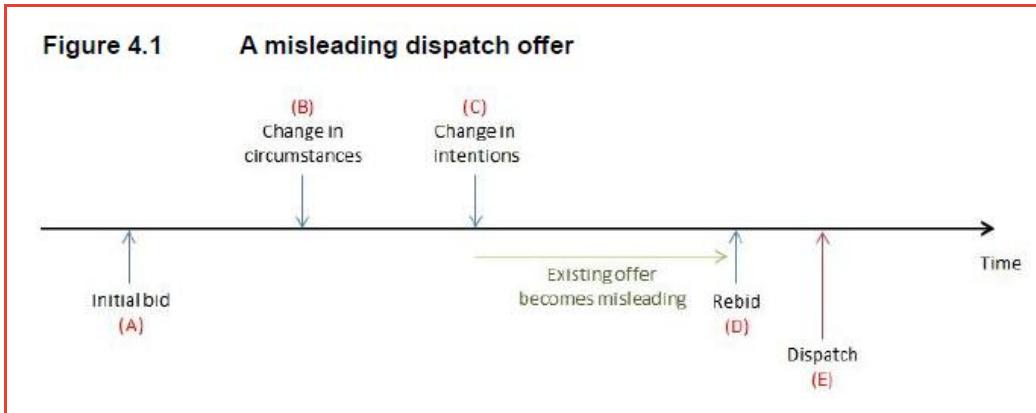
The NER also obliges rebidding participants to make any bids or rebids in good faith, meaning that at the time the bid or rebid is made, the participant had a genuine intention to honour that bid or rebid if the material circumstances on which it was based remained unchanged (clause 3.8.22A). The NER allows that the participant's intention can be inferred from the surrounding circumstances.

The AEMC's concerns about deliberate late rebidding can be identified more clearly by using the stylised timeline used in the SDRD (see Figure 7). The timelines shows the following events:

- Generator makes an initial bid (A)
- Change in circumstances occurs (B)

- Change in generator's bidding intentions occurs (C)
- Generator rebids (D)
- Dispatch occurs (E)

Figure 7: When does a dispatch offer become misleading?



Source: AEMC SDRD, Figure 4.1, p.41.

The AEMC commented that between the change in the generator's bidding intentions (C) and the time it rebids (D), the generator's initial bid becomes misleading as it no longer reflects the generator's true intentions for dispatch.²⁵

While the change in circumstances referred to in (B) may include events such as a transmission line or plant outage, the AEMC noted that it could also include a trader's subjective expectations not being met:²⁶

The Commission does not consider that the [South Australian Minister's] proposed rule to limit the reasons for a rebid to objectively observable changes in conditions and circumstances would benefit the market in the long term interests of consumers. The exclusion of participants' subjective expectations as a reason for a rebid may have the effect of restricting efficient price discovery.

The AEMC went as far as to say:²⁷

...it is not the change in market conditions that triggers generators to adjust their position but rather the change in their expectations. While a change in the environment that is readily observable and objective may trigger a change in expectations, it could also occur in the absence of such a change.

²⁵ SDRD, p.33.

²⁶ SDRD, p.41.

²⁷ SDRD p.41.

Economic efficiency and NEO implications

3.2 Key obligations under the draft Rule

This section begins by summarising how we interpret the operation of the draft Rule, drawing heavily on the explanation offered by the AEMC. It then proceeds to highlight aspects of the draft Rule that are unclear or appear to contradict the stated intent of the draft Rule as expressed by the AEMC in its SDRD.

3.2.1 Intended operation of the draft Rule

The AEMC's proposed draft Rule comprises three key elements, which we have summarised and interpreted as follows:

- **An obligation on participants to not make bids or rebids that are false, misleading or likely to mislead**, having regard to a revised market design principle (which stresses the importance of transparency and timeliness of market information). The obligation is breached where the participant does not have:

- a genuine intention to honour the bid or rebid or
- a reasonable basis to make the bid or rebid,

either of which may be inferred from the surrounding circumstances.

In addition, each bid (or rebid) by a participant is deemed to represent to others that the bid will not be changed unless the participant becomes aware of a change in the material conditions and circumstances upon which the bid is made.

See: Rule 3.8.22A(a)-(c)

- **An obligation on participants to rebid as soon as practicable** after the participant becomes aware of the change in material conditions and circumstances on the basis of which it decides to vary its earlier bid, with compliance to be judged having regard to the revised market design principle and the importance of rebids being made in sufficient time to allow other participants to respond.

See: Rule 3.8.22A(d)-(e)

- **An obligation to make a contemporaneous record** of the following matters in relation to a rebid made during a 'late rebidding period' (being the period commencing 15 minutes before the relevant trading interval commences through to the end of the trading interval):

- The material conditions and circumstances giving rise to the rebid
- The participant's reasons for making the rebid
- The time at which the relevant event or other occurrences occurred

- The time at which the participant first became aware of the relevant event or occurrence.

See: Rule 3.8.22(ca)

3.2.2 Serious flaws in the draft Rule

In our view, the wording of the draft Rule embodies a number of serious flaws. Most importantly, it appears to contradict the AEMC's intent as articulated in its SDRD. The draft Rule also creates obligations that appear ambiguous, unworkable and/or ill-advised, giving rise to a great deal of uncertainty as to how the Rule will operate in practice. In our view, it is inconsistent with good regulatory practice for these flaws to be left unresolved if the AEMC proceeds with a final Rule change.

We discuss these flaws below in what we consider to be their order of importance.

As soon as practicable (clause 3.8.22A(d))

As noted above, under the draft Rule, a participant is obliged to place any rebid 'as soon as practicable' after it:

...becomes aware of the change in material conditions and circumstances on the basis of which it decides to vary its dispatch offer or dispatch bid.

This wording is extremely unclear. It appears to suggest that the obligation to rebid arises as soon as practicable after the participant becomes aware of changes in material conditions and circumstances that result in the participant *subsequently deciding* to change its bid. This could imply that the participant is obliged to lodge a rebid before it has actually decided – on the basis of the change in circumstances – to vary its bid. If this interpretation was correct, it may be impossible for a participant to comply with such an obligation. Further, it would conflict with the views of the AEMC as stated in section 4.1 of the SDRD and cited above that a generator's original offer only becomes misleading at the point in time – after any relevant change in circumstances – when the generator actually changes its intentions and decides to rebid.

If the draft Rule is to reflect the AEMC's stated intention, the wording of draft clause 3.8.22A(d) ought to be changed to clarify that the obligation to rebid arises after the participant has decided – on the basis of the relevant change in material conditions or circumstances – to rebid.

Court must have regard (clause 3.8.22A(e) and (b1))

In determining whether a participant has complied with clause 3.8.22A(d) in making a rebid as soon as practicable, clause 3.8.22A(e) of the draft Rule requires a court to have regard to two key matters:

- A new more expansive transparency limb of the market design principle in clause 3.1.4(a)(2) and
- The importance of rebids being made in sufficient time to allow other participants to respond to the rebid before the commencement of the relevant trading interval or a dispatch interval within that trading interval.

It is not clear what relevance these two matters have to the practicability of a participant rebidding within a certain timeframe. The term ‘practicable’ is an adjective meaning “capable of being done; feasible”. It necessarily and exclusively refers to the circumstances faced by the participant – for example, matters such as the need to comply with the new contemporaneous record-keeping obligation contained in the proposed draft clause 3.8.22(ca) and the normal internal approval processes of the participant. In our view, it is inappropriate to insert wider market objectives into a consideration of whether it is practicable for a participant to take some action within a certain period of time. It appears to reflect an invitation by the AEMC to a court to decide that a participant did not rebid ‘as soon as practicable’ because even though the participant rebid as soon as it realistically could, the participant somehow failed to rebid even sooner in light of the wider market objectives of transparency, competitiveness and efficiency.

As an analogy, consider a situation where a car driver is obliged to brake ‘as soon as practicable’ if faced with any obstacle on the road. Such an obligation would imply that the driver should brake as soon as he or she realistically could, regardless of the nature of the obstacle. The time permitted for a driver to brake ‘as soon as practicable’ would not vary according to whether the obstacle was a human being or an empty cardboard box. However, what was ‘as soon as practicable’ would vary according to whether the driver was young and fit with good eyesight or old and infirm with poor eyesight; because these characteristics affect the ability of the individual who is subject to the obligation to engage his or her car’s brakes. Therefore, we submit that parts (1) and (2) of clause 3.8.22A(e) (and the words leading into them) ought to be removed.

Similarly, in determining whether a participant’s bid is false or misleading under clause 3.8.22A(a), clause 3.8.22A(b1) of the draft Rule requires a court to have regard to the new more expansive transparency limb of the market design principle in clause 3.1.4(a)(2). However, it is difficult to see how the value of high transparency as a means to greater market efficiency is relevant to a consideration of whether certain conduct is false or misleading – conduct is either false or misleading, or it is not, irrespective of the wider utility of truthful conduct.

To take another analogy, whether an accountant falsely claims a sick leave day from his employer:

- on the last day of the financial year, when the tasks he would ordinarily perform would have a very high value or
- the second of January, when the tasks he would ordinarily perform would be of low value,

is irrelevant to whether the sick leave was falsely taken.

For this reason, clause 3.8.22A(b1) should be deleted.

No reasonable basis to make (clause 3.8.22A(b))

As well as changing the present good faith obligation in the NER to a ‘no false or misleading bid’ obligation, the draft Rule deems a participant’s bid to be false or misleading if the participant ‘does not have a reasonable basis’ for making the representation implied in the bid. This goes beyond the current requirement that a participant’s bid must represent its honest intention to honour the bid if material circumstances do not change. What is a reasonable basis upon which to make a representation is to depend on the circumstances. In the SDRD, the AEMC gave the following example of how this requirement could work in practice:²⁸

One example of behaviour that could be covered by relying only on the “reasonable basis to represent” limb is a situation where it is not able to be proven that the generator had the actual intent not to honour its offer, but the AER alleges that there was a consistent pattern of the generator making a low initial offer but then rebidding volume to higher price bands in the last dispatch interval of a trading interval, without any obvious change in “material conditions and circumstances”. This could provide an indication that there was a lack of a reasonable basis to represent that the offer, bid or rebid would not be changed unless in response to a change in material conditions and circumstances. This clause should therefore give the AER greater ability to bring an enforcement action where such behaviour is observed.

If the example above is correct, we submit that the AEMC’s proposed draft Rule inappropriately prioritises the ease of the AER taking enforcement action over good regulatory practice and natural justice to rebidding participants. We note that the AEMC explained that the proposed provision was analogous to the treatment of statements of future matters under section 4(1) of the Australian Consumer Law (ACL) where:²⁹

...a representor’s statement as to its own future actions is taken to have been made upon reasonable grounds if, at the time of making the statement, the representor intended to, and objectively had the capacity to, perform the future act.

²⁸ SDRD, p.46.

²⁹ SDRD, p.50.

The key element in the reasonable grounds limb in section 4(1) of the ACL is that apart from having an intention to honour its representation, the representor objectively *had the capacity to perform* the future act. For example, a representor would not have a reasonable basis to make a representation that it would provide customers with a choice of refund or replacement of a widget if the widget was no longer in production and was out of stock. Effectively, the lack of a reasonable basis for the representation becomes a means of avoiding the difficulty of proving the lack of an honest intention in cases where that *intention could not reasonably have been held* by the representor.

This is fundamentally different to the Commission's suggestion. Effectively, the proposal deems a participant's bid false or misleading not because the participant did not honestly intend to honour the bid, or because the participant lacked the capacity to follow-through with the earlier bid, but because a third party (the AER or a court) did not think (after the fact) that the participant's bid was *likely* to remain unchanged based on an ex post review of circumstantial evidence.

Consider an example of a plumber who changed the time of an appointment a few times with a householder but now promises to attend the next appointment. The householder may consider that based on his observed behaviour the plumber does not honestly intend to keep the appointment or is unlikely to fulfil his promise, but it cannot be said that the plumber lacks the capacity to attend the appointment. Likewise, to impugn an earlier bid as false or misleading (and to sanction it as such) after the fact of the bid's alteration even though the participant honestly intended to fulfil the earlier bid and had the ability to do so is an excessively harsh and capricious means of easing the AER's enforcement burden. It is arguably a denial of natural justice and a violation of good regulatory practice. If the draft Rule proceeds, it should be limited to allowing the AER or a court to infer – if it justifiably can – a participant's lack of an honest intention from surrounding circumstances rather than inferring a lack of 'reasonable basis' to make the earlier bid.

Alternatively, if lack of reasonable basis is to remain in the draft Rule, it should be defined in a manner consistent with the ACL provision cited by the Commission. That is, it should explicitly refer to circumstances where the participant lacked the capacity to comply with the bid. For example, it could apply where the participant's plant was unavailable. Of course, such bidding behaviour is already proscribed under the NER 4.9.8(b).

Contemporaneous record (clause 3.8.22(ca))

The final issue we have with the drafting of the proposed Rule relates to the matters that a participant making a rebid in a late rebidding period must record. These are summarised as follows:

- The material conditions and circumstances giving rise to the rebid (i)

- The participant's reasons for making the rebid (ii)
- The time at which the relevant occurrence occurred (iii)
- The time at which the participant first became aware of the relevant events or other occurrence (iv)

The current proposed Rule affirms our concern raised in relation to draft clause 3.8.22A(d) that contrary to the AEMC's expressed view in the SDRD, the draft Rule obligation to rebid arises:

- when the participant becomes aware of changes in material conditions and circumstances that result in it *subsequently deciding* to change its bid,
rather than
- when the participant actually decides – on the basis of the change in circumstances – to change its bid.

As noted above, such an interpretation could make it impossible for a participant to comply with the obligation.

We suggest that if the AEMC decides to proceed with the draft Rule, parts (3) and (4) of clause 3.8.22(ca) should be removed and a new (3) be inserted that refers simply to the time the participant decided to make the rebid.

3.3 Likely effect of the draft Rule

The purpose of the AEMC's proposed draft Rule is ostensibly to encourage generators to make any rebids they wish to make as soon as practicable after identifying a reason to do so, in order to maximise opportunities for other participants to respond and promote efficiency. Such responses could include rebidding of in-service capacity to lower price bands, additional supply from fast-start gas turbine or hydro plant or demand-side response from customers directly or via aggregators or other energy service businesses.

However, it also appears that – despite refraining from limiting participants' permissible reasons for rebidding – by seeking to oblige participants to rebid earlier than at present, the draft Rule is intended to deter participants from rebidding in such a way as to raise spot prices. In other words, by imposing this Rule, the AEMC appears to be indirectly seeking to reduce the incidence of rebidding by participants that it considers undesirable. To the extent this is the case, it stands in stark contrast to the AEMC's previous and more measured approach³⁰ to the exercise of transient market power. To date, NEM policy-makers have refrained from altering the market rules to address occasional instances of transient market power because the costs of attempting to proscribe

³⁰ AEMC, *Potential Generator Market Power in the NEM, Final Rule Determination*, 26 April 2013.

such behaviours are believed to outweigh the benefits in a workably competitive market.

We submit that so-called ‘deliberate late rebidding’ – assuming it can be practically identified as having occurred – raises exactly the same issues as transient market power in that attempts to proscribe such behaviour will invariably impose more costs than benefits. In particular, we submit that it is unrealistic to assume that just because the AEMC hopes to achieve a certain outcome from its draft Rule, such an outcome will necessarily eventuate. Rather, we submit that depending in part on how the fundamental ambiguities discussed above are resolved, the draft Rule could give rise to a range of perverse incentives that may harm the efficiency of market outcomes. Some of these perverse incentives and inefficient effects are discussed below.

3.3.1 Deter efficient late rebidding

It is quite possible that the draft Rule could deter all late rebidding, even where rebidding close to dispatch helps to increase low-priced supply and reduce spot price outcomes. This could occur if generators fear that the AER will query why any late increase in low-priced supply did not occur earlier. In particular, generators may fear that a late increase in supply could be regarded by the AER as undermining DSM or peaking generators by encouraging such parties to incur commitment costs but then – due to the generator’s late ‘down’ rebid – losing the opportunity to be dispatched.

Alternatively, the draft Rule could encourage earlier rebids, but with little or no effect on spot prices if in fact it is other factors like high demand, interconnector limits or plant outages that are the underlying cause of the high prices.

3.3.2 Encourage ‘unwieldy rebids’

Even if our suggested change to clause 3.8.22A(d) of the draft Rule were made, it may effectively oblige rebidding participants to rebid for the remainder of any conceivable tight demand-supply balance period. Participants may not be permitted to rebid only in respect of an approaching trading interval because to do so could imply that they did not rebid as soon as practicable in respect of later trading intervals. If participants do subsequently rebid in respect of later trading intervals, they could potentially be found in breach of the NER.

For example, if a participant decides at 3:15pm to rebid in respect of the 3:30-4pm trading interval, it may effectively be obliged to rebid in respect of all succeeding trading intervals that it may potentially later seek to rebid. If the participant, say, submitted a rebid in respect of all trading intervals from 3:30 to 6pm inclusive, but omitted to rebid in respect of a trading interval later in the evening and subsequently did rebid, it could face the accusation that it breached this obligation if the later rebid could be attributable to an earlier event that gave

rise to the earlier rebids. This could ultimately require participants to engage in unwieldy and uninformative rebids covering a large number of trading intervals whereas at present they rebid as and when necessary. Such unwieldy rebids could serve to confuse and misinform the market, by potentially increasing the volatility of pre-dispatch prices and/or reducing accuracy relative to actual outcomes, giving rise to costly generator start-ups and DSM preparation.

3.3.3 Administrative burden and inefficiency

Rather than focusing on their primary role, the draft Rule may force traders to focus on contemplating and recording the timing of every change in their:

- information set, including external circumstances and subjective expectations and
- however-inchoate future intentions,

as if such changes occurred in a discrete-time rather than continuous-time manner.

Traders are likely to be advised by their firms' compliance departments to devote much more time to focusing on these matters, diverting them from bidding their plant in a manner most responsive to market conditions. This is despite the fact that until a trader's decision is effected through action (ie a rebid), it remains just one of many possible courses of action that may or may be proceeded with.

Further, it is unclear how the AER will seek to audit or otherwise police the recording by traders of such unobservable changes. We are concerned that apart from violating tenets of natural justice and good regulatory practice, the uncertainty and workload arising from how the AER may implement the draft Rule will give rise to greater cost and less responsive rebids, harming the efficiency of the NEM in contravention of the NEO.

3.3.4 Little impact

While the draft Rule is unclear, there does not appear to be any prohibition in the draft Rule against a participant deciding to rebid and actually rebidding only at the point in time when the participant considers that other parties will not be able to respond to the rebid. This is because the presumed expiry of the opportunity for any potential generation or DSM response to a generator's rebid is itself a 'change in material conditions and circumstances' that a participant may consider makes a rebid worthwhile. Generators would justifiably claim that a 'change in material conditions and circumstances' occurred close to dispatch.

Furthermore, if the draft Rule is clarified as we suggest – to reflect the AEMC's stated intentions in the SDRD – then clause 3.8.22A(d) may have little impact on market outcomes. This is because generators could justifiably claim that they did not form an intention to rebid until they actually rebid. In this context, it is not

clear how the AEMC intends the AER to monitor or enforce the timing of a change in intentions.

3.4 Summary

Contrary to the stated intention of the AEMC in the SDRD, the draft Rule creates obligations that appear ambiguous, unworkable and/or ill-advised, giving rise to a great deal of uncertainty as to how the Rule will operate in practice. In our view, it is inconsistent with good regulatory practice for these flaws to be left unresolved if the AEMC proceeds with a final Rule change.

Even if the flaws noted in this section are resolved, we submit that the draft Rule could give rise to a range of perverse incentives that may harm the efficiency of market outcomes.

4 Conclusion

The SDRD does not make a strong case for amending the NER in accordance with the draft Rule.

First, the SDRD does not clearly define the meaning of ‘deliberately late rebidding’ and how this differs from the rational behaviour that is expected of a market participant and that the AEMC itself appears to approve of. Likewise, the AEMC does not cite any specific examples or provide any clear evidence that misleading and undesirable rebidding close to dispatch occurs or has ever occurred in the NEM.

Further, the AEMC has also not demonstrated that what it describes as ‘deliberately late rebidding’ is responsible for the magnitude of economic harm it claims, because it has derived its estimates of economic harm from an analysis of all rebidding close to dispatch rather than just ‘deliberately late rebidding’. This suggests that any estimates of economic harm derived by the Commission must be regarded as speculative.

A fundamental problem with the empirical estimates prepared by the AEMC’s consultants is that they assume – for no clear or robust reason and despite self-described evidence to the contrary – that a reduction in price volatility in late dispatch intervals would not result in an offsetting increase in price volatility in earlier dispatch intervals. The estimates also suffer from various flaws that systematically over-estimate the likely harm resulting from late rebidding and underestimate the costs of addressing it.

The AEMC’s attempts to curb ‘deliberate late rebidding’ stand in stark contrast to its more measured approach to the exercise of transient market power. This is despite the fact that, in theory, both forms of behaviour are may be fundamentally similar and are equally difficult to prevent without imposing highly prescriptive and intrusive obligations. As with transient market power, we submit that attempts to proscribe ‘deliberate late rebidding’ will invariably impose more costs than benefits.

Some of the problems associated with the draft Rule stem from serious flaws with its drafting, which give rise to obligations that are unworkable or ill-advised:

- First, the draft Rule appears to impose an obligation that is impossible to comply with: The obligation on a participant to submit a rebid potentially before it has even decided to rebid. This is despite the text of the SDRD stating that it is only after a participant has decided to rebid that its earlier bid potentially becomes misleading.
- The draft Rule also inappropriately invites the AER or a court to consider wider market objectives when determining whether a participant has rebid as soon as practicable.

- Perhaps most worryingly, the draft Rule allows the AER or a court to find a bid false or misleading even where the participant genuinely intended to honour that bid at the time it was made and had the capacity to do so.
- The new record-keeping obligations under the draft Rule reinforce our concerns regarding the impossibility of complying with the obligation to rebid as soon as practicable.

Even assuming these drafting flaws can be addressed, the draft Rule is likely – if adopted – to have a number of perverse incentives that may harm the efficiency of market outcomes. These include:

- Deterring efficient late rebidding
- Encouraging unwieldy rebids which could reduce the veracity of pre-dispatch information and
- Imposing administrative burdens that are likely to undermine efficient outcomes.

Finally, if the draft Rule is amended to overcome the issues we have raised, it may have little effect on bidding behaviour despite retaining most of its costs of compliance.

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