



Australian Energy Markets Commission

**National Electricity Amendment
(Bidding in good faith) Rule 2014**

Reference Code ERC0166

Comments on the Second Draft Decision

Submission by

The Major Energy Users Inc

October 2015

**Assistance in preparing this submission by the Major Energy Users Inc (MEU)
was provided by Headberry Partners Pty Ltd**

**The content and conclusions reached in this submission are entirely the work
of the MEU and its consultants.**

1. Introduction

The Major Energy Users Inc (MEU) welcomes the opportunity to provide comments on the AEMC's Second Draft Rule decision on rebidding. This has been issued as part of its assessment of the rule change proposed by the SA Government to address the observed use by generators of rebidding as a tool for increasing their prices when market conditions do not warrant such an increase in price. The SA Government rule change proposal has been consistently and strongly supported by the MEU.

In its response to the first draft rule decision, the MEU noted that the AEMC has consistently moderated rule change proposals aimed at reducing the exercise by generators of the market power they might have from time to time. These proposals were from:

- the MEU to minimise the power of generators from economically withdrawing capacity in order to increase the market spot prices
- the AER to prevent generators using ramp rate bidding as a tool to set prices above competitive levels
- the SA government to prevent generators rebidding for any reason other than as a result of changes in the market.

The MEU notes that each of the rule changes proposed are effectively the result of issues from the electricity market structure - some generators being dominant in their regions, "gaming" by generators with the ramp rates needed by the market, insufficient capacity in critical elements in the transmission network and, most recently, a proposal to prevent generators using exercise of their market power through late rebidding to prevent competition.

In most of the AEMC determinations on issues concerning the exercise of market power, there has been a common theme from the AEMC, that:

"...where the Commission [forms] the view that "engineering a solution to a problem that does not stem from the operation of the rules, but from competition and market structure issues, [this] would be an inappropriate use of the Commission's rule making powers"¹

The MEU raises the very reasonable concern that, if the rules are not the place to address such issues of competition and market structure, where can consumers get relief from generators exercising the market power they have through lack of competition and/or a market structure that enables such exercise?

¹ Second draft rule determination page 31

The MEU notes that in other competitive electricity markets, regulators and rule makers are not so accepting of generators exercising market power as the AEMC appears to be. In these other markets, there are rules which are made in order to address market power, even when the cause is a result of competition and/or structural issues. The MEU has consistently asked what is so different about the NEM that the AEMC approach to rule making continues to allow some generators in the NEM to exercise their market power to the detriment of consumers?

The National Electricity Objective (NEO) - to which the AEMC is required to assess rule change proposals - states that

“The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:

- (a) price, quality, safety, reliability and security of supply of electricity; and
- (b) the reliability, safety and security of the national electricity system.”

The MEU asks how does the AEMC reach the conclusion from the NEO that it should not make rule changes that address the shortcomings in competition and market structures that allow the exercise of market power? The exercise of market power results in outcomes that are less efficient than would result from a competitive market and therefore reflect less than efficient market operations and can be even detrimental to investment.

The MEU considers that the AEMC has not only the ability to address issues where the rules could lead to improved competition and mitigate the negative impacts of a market structure which provides generators with the ability to exercise market power, but has the responsibility to do so.

The MEU reiterates the concerns raised in its response to the first draft rule determination that the AEMC puts a potential disincentive to invest in generation at some time in the future as a greater risk to the long term interests of consumers over actions of current consumers which are driven by the high prices caused by the exercise of market power and which will also have a negative impact on consumers in the future. The failure by the AEMC to balance the immediate impacts with future impacts has led to the AEMC not complying with the requirements of the NEO.

Despite its concerns that the AEMC has not addressed the issue of rebidding and market power to the extent that it should have, the MEU does accept that the AEMC developed a first draft rule and has further refined this with a second draft rule, which is better for consumers than the current rules. Despite this support, the MEU considers the SA government proposed change would provide an overall better outcome for consumers than the AEMC second draft rule.

Specifically, the MEU points to the basis of the SA Government rule change proposal in that generators should only be allowed to rebid when there is an observable and significant change in the market. Whilst a rebid made as a result of a change in the market is observable (and therefore allows an objective assessment to be made as to its legitimacy), the AEMC accepts that rebids made on expectations should be an acceptable reason for a rebid. A change made on the basis of an expectation is subjective and cannot be measured in any clear way and leaves the assessment of any possible transgression that much harder to prove.

The MEU points out that AEMO provides a regularly updated view of what the market is likely to do and bids are made on the basis of this forecast. If the forecast is accurate, then making a change to a bid based on the expectation that something else might occur provides a prima facie view that the initial bid or the rebid might well be false but certainly misleading or likely to mislead. The basis of the SA government rule change is that a legitimate rebid should be based on an observable change in the market. The AEMC acceptance that a rebid can be made based on expectations provides a clear avenue for dispute.

In the view of the MEU, both of the first draft rule and the second draft rule, to allow a generator a clear opportunity to be able to claim that a rebid was made in expectation of a change, significantly opens up scope for debate. On this basis, even if that expected change does not eventuate, the AEMC still considers that the rebid was not necessarily made as false, misleading or likely to mislead.

The MEU notes the detailed article on 19 October 2015 in the Australian Financial Review which discusses the proposed rule change². While the article supports the AEMC in making a change, it also highlights that there is a strong view that the proposed changes will not achieve what is targeted by the draft rule change. Specifically, at the end of the article there is a statement:

"A leading law firm in Queensland has provided advice to energy market participants that the late rebidding strategy used by Stanwell and CS Energy will likely continue after trading rules are changed."

The MEU is of a similar view to that expressed; that the change will not prevent the exercise of market power used through rebidding practices.

For example, on 20 August 2015 in the 7 am dispatch interval in Queensland, there was a price spike up to the market price cap in the last dispatch interval of the trading period. There were a number of contributing factors, including³:

² available at <http://www.afr.com/brand/chanticleer/energy-regulator-moves-to-ban-false-and-misleading-bidding-20151019-gkcx2>

³ The MEU thanks Paul McArdle of Global-Roam for this detailed explanation. Paul does not draw any conclusions from this series of events and his thoughts about the complexities of the rebidding

1. CS Energy had dispatched Kogan power station (operated by CS Energy) to maximum output and effectively constrained QNI. When constraint on QNI occurs, sufficient generation is required to be dispatched in Queensland to ensure continuity of supply should Kogan trip.
2. More output from other Queensland based generators was required because Oakey power station was constrained due to a trip on the Middle Ridge to Tangkam power line.
3. This meant that Gladstone power station (controlled by CS Energy) had to run because there was no other generation that could be dispatched in time. Gladstone unit 1 rebid to market price cap quoting the reason:

“06:51 5-minute predispatch higher than 30-minute predispatch. See Log”

The conclusion that MEU draws from this series of events is that effectively CS Energy used its market power to spike the spot price to set the regional price for the entire 30 minute trading period at a significant premium to the short run marginal price that applied for the other 25 minutes of the trading period.

The question then to be asked is - did CS Energy know it had market power when it implemented its actions? The MEU considers that clearly CS Energy thought it had market power (or the likelihood of it) or it would not have acted the way it did.

The next question is whether CS Energy would have been found to have transgressed the second draft rule. The example highlights that in all probability the second draft rule change would not have prevented this exercise of market power through rebidding by CS Energy as it could cite that there was a change that allowed the rebidding of Gladstone unit 1 to the market price cap. In fact, the change was initiated by CS Energy by it creating the conditions which led to Gladstone Unit 1 being able to exercise its market power. This example shows that, by careful preparation, the second draft rule can be circumvented.

The MEU sees that the ability to exercise market power in Queensland will be further enhanced should the Queensland government implement its proposal to merge CS Energy and Stanwell into one generation company. That such structural changes can be made in the NEM relatively easily (there was little concern about the reduction of the three Queensland government owned generators into two) and the AEMC persistence in not changing the rules to address consumer harm from such competition and market structural issues continues to be a major concern for the MEU and other consumers.

Because of the way the rebidding can be used to the detriment of consumers, the MEU is still very much of the view that the gate closure mechanism used widely in other competitive electricity markets would minimise the potential for exercise of market power through rebidding, but the MEU also notes that the AEMC has expressly disregarded gate closure as an acceptable tool for minimising the exercise of market power through rebidding on the basis that it is:

"...a disproportionate response that would involve fundamental changes to the design of the wholesale market. Such changes could have unintended consequences, including on the ability of participants to make efficiency-enhancing late rebids. It was also not sufficiently demonstrated that the potential costs associated with restricting efficient rebids close to dispatch would be outweighed by the benefits of preventing generators submitting deliberate late rebids." (page 62)

The MEU considers the AEMC has erred in reaching this conclusion, particularly as the AEMC has not quantified the potential costs that might accrue through the loss of "efficiency-enhancing late rebids". In this regard the MEU notes that the potential benefit from "efficiency-enhancing late rebids" is small as such rebids can only result in relatively small downward price movements whereas late rebids causing price hikes have an impact of nearly 300 times the average spot price.

Throughout the review process, the MEU has provided its views in significant detail to the AEMC. The MEU considers that its concerns about late rebidding have only been partially addressed by the AEMC in this second draft rule. The MEU notes that, despite the various AEMC documents generated in the review process, these have not assuaged concerns that rebidding will continue to be used when a generator has market power. As a result, there will continue to be significant detriment of consumers.

However, rather than reiterating all of the MEU arguments provided in previous submissions, the balance of this response is directed to assessing the merits of the changes proposed from the first to the second draft determination.

2. The Second Draft Determination

Whilst retaining much of the first draft rule, the AEMC has decided that the first draft rule would be enhanced by the following five changes:

1. Including a definition of what is represented to the market when a legitimate bid or rebid is made
2. The two conditions precedent initially requiring both to be proven for identifying legitimacy of a rebid are now changed to requiring just one or the other - ie proof that one or the other is sufficient rather than proving both
3. To rebid as "reasonably practicable" in time after becoming aware of change is now to be just "practicable" with regard to time
4. The requirement to report on every rebid in relation to those made for the next trading period but made after 15 minutes before that trading period has been relaxed so that contemporaneous information used as the basis for making the rebid must be retained and this used to provide advice to the AER if queries are raised on a rebid(s)
5. A clarification that a court should take into consideration the importance of rebids being made within sufficient time rather than just whether a rebid was made in sufficient time

The MEU thanks the AEMC for the development of table "Summary comparison of market conduct provisions" on pages viii and ix. This made comparisons much clearer and easier to track through the various changes between the current rule, the proposed SA government rule, the first draft rule and the second draft rule.

2.1 Definition

The MEU supports the inclusion of a definition as to what is expected of a bid and rebid.

However, the MEU is still concerned that a rebidder's expectation and even an expectation of what another bidder's expectation might be as acceptable reasons for making a rebid, provides considerable scope for subverting the intentions of the second draft rule change.

2.2 Conditions precedent

The MEU considers that making either of the conditions precedent sufficient to establish false or misleading bidding, is a significant improvement and is supported by the MEU.

The MEU considers that there will still be significant difficulty in the AER demonstrating and the court deciding that a bid or rebid was false or misleading. The second leg of the requirement is, in the view of the MEU, where the real ability of the AER to demonstrate false and misleading bidding occurred, and the decision to move from both of the conditions precedent having to be proven, to one or the other, will provide a greater ability for the AER to demonstrate that false and misleading bidding has occurred.

2.3 Reasonably practicable

The MEU supports the removal of "reasonably practicable" and replacement with "practicable".

The MEU considers that "reasonably practicable" is not clear as to what is intended and has connotations of a double modifier which further softens the intent. "As soon as practicable" is a well used approach for assessing when an action could and should have been carried out.

2.4 Reporting

The MEU supports the removal of the provision for a report to be sent to the AER for every rebid made after 15 minutes before the next trading period

The MEU recognises that there would be a significant impost, not only on the generator but also the AER in requiring the generation of a report for every rebid made after 15 minutes before the start of the next trading period. In reality, the MEU sees that insisting on the requirement would have been a powerful tool in overcoming the intent of the rule change by inundating the AER with so much information that it would have difficulty in carrying out its monitoring function.

By allowing the AER to identify when it considers a generator might not be complying with the rules, permits the AER to more properly carry out its monitoring functions. By making the generators retain sufficient information to demonstrate (or not) compliance still imposes the responsibility on the generator to provide evidence of its compliance.

The MEU considers that the AER should develop a guideline as to the detail and extent of information required to be retained would be an enhancement of the change.

2.5 Clarification of what is expected

The MEU supports the rules being explicit as to the importance of timing in relation to rebids.

The MEU considers that any review of market conduct by the AER will most likely be made in full knowledge of the implications of the harm to consumers of that market conduct. More importantly, any assessment made by a court of that market conduct should be made in full knowledge of why the rule has been made and that the implications of transgression for consumers can be very significant and damaging to their interests.