



22 May 2014

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Pierce

National Electricity Amendment (Bidding in good faith) Rule 2014

Alinta Energy welcomes the opportunity to make a submission in response to the consultation paper on the proposed *National Electricity Amendment (Bidding in good faith) Rule 2014* (the proposed rule or the proposal) lodged by the South Australian Minister for Mineral Resources and Energy.

Alinta Energy is an active investor in the energy retail, wholesale and generation markets across Australia. Alinta Energy has around 2500 megawatts of generation capacity in Australia (and New Zealand) and a growing retail customer base of over 750,000.

Alinta Energy actively trades in the National Energy Market (NEM), notably in the “spot market”, and utilises rebidding for a large generation fleet. The proposed rule, if implemented, would mark a significant departure from the status quo. Alinta Energy would be directly affected by additional costs and risks pursuant to the proposed rule.

Discussion

Alinta Energy approaches the proposed rule from three perspectives. First, the implication of the Federal Court decision handed down in August 2011 in relation to allegations made by the Australian Energy Regulator (AER) regarding Stanwell Corporation (the Federal Court decision). Second, whether there is any justification, in terms of economic efficiency, for changing the current rules and thus moving away from the status quo. Finally, to what extent the proposed rule could be practically implemented.

Alinta Energy appreciates the proponents concern that the Federal Court decision may place a substantial burden of proof on the AER. Alinta Energy would go so far as to agree that those suspicious of rebidding would be particularly concerned by this outcome. Whether this undermines the original intent of good faith provisions is open to greater interpretation.

Nonetheless, in relation to the Federal Court decision the proposed rule has the sole and unique purpose of lowering the threshold to establish a case for enforcement action against a proponent than is currently the case in the NEM. It should not be forgotten that the Federal Court decision clarifies the status quo.

In fact, the proposal goes so far as to increase dramatically the obligations on market participants and it can be argued creates a reverse onus of proof. Supporters of the rule change have not been shy in commenting that the proposal will have the effect of lowering the threshold for prosecution.

As such, it is critically important to assess the proposal against the National Electricity Objective and whether the proposal promotes economic efficiency. This is in many respects regardless of what the proponent's subjective understanding of the intent of the original good faith provisions.

On this count, Alinta Energy does not believe the rule change provides any benefit to the market or consumers in terms of economic efficiency and has been poorly justified by the proponent. It is unfortunate that the proposal has made it this far given these issues have been previously addresses and a general understanding that the rule does not promote economic efficiency and in fact is likely to have the opposite impact.

As it pertains to practical implementation of the proposed rule, it again fails and shows limited understanding of how market participants actually engage in the market, utilise information and rely on the experience and capacity of its traders. Whether it's the additional and unobtainable information obligations, the impractical and imprecise expectations around when rebidding would take place or the uncertain meaning of 'materiality' the rule proposal cannot be successfully implemented.

Given the singular and questionable legal intent that is without justification from an economic efficiency perspective and is wholly impractical, Alinta Energy recommends the Australian Energy Market Commission (AEMC) not proceed with this proposal or be minded to manufacture an alternative or 'preferable' rule change.

These issues are enunciated later in this submission.

The good faith provisions and the Federal Court decision

The AEMC notes within the consultation paper the original changes to the National Electricity Code were driven by two factors:

- improve the reliability of pre-dispatch forecasts in each interval; and
- address aspects of generator's bidding that were of concern and were claimed to cause short-term price spikes.

These proposals were not intended to restrict rebidding but to ensure that generator bids were honoured.

Alinta Energy notes there is little in the way of evidence to suggest that pre-dispatch would be more reliable under the proposal or prior to the Federal Court decision, or in fact that even if this were the case, should the proposal be implemented, that market outcomes would overall be more efficient. This is the case given it is accepted that rebids that move the market away from pre-dispatch that deliver more efficient outcomes are beneficial not concerning.

Alinta Energy does not consider it necessary to consider whether the reforms at the time were justified or represented an over-reaction based on non-economic imperatives. While it is possible to reflect on the general concern some observers have in response to price spikes generally, and note attempts to distinguish between 'good' volatility and 'bad' volatility are nonsensical, for the purposes of this rule proposal this does not matter.

This is because for the purposes of this rule proposal the assessment criteria is the National Electricity Objective not the proponent's subjective interpretation of the intent of the initial changes to the National Electricity Code.

The proponents sense that the Federal Court decision has made it more difficult to achieve successful legal prosecutions against participants because the Federal Court recognised that traders' subjective expectations are in fact material conditions and circumstances upon which rebids can be

based is likewise irrelevant, even if true, unless the status quo can be demonstrated to be leading to outcomes that are not efficient. However, as is widely known, but rarely stated, arguments around rebidding are generally coloured by subjective views and emotive bias not objective evidence.

In this regard, while bidding and rebidding in good faith remains an important facet of the market and the National Electricity Rules, this proposal would not improve the operation of the market and Alinta Energy contends that the Federal Court's position has not undermined the functioning of the market.

This is an important point as it is Alinta Energy, like other market participants, utilise pre-dispatch and other data. If there was a genuine concern that the integrity of the market and forecasts were being compromised it would be market participants who are financially invested in the market and face ongoing market risks, not government, that should be raising any relevant concerns.

On this point, Alinta Energy notes that there is genuine frustration where participants are lodging bids or rebids that they would be technically unable to honour should they be dispatched but that they continue to lodge these false bids for the purposes of generate specific outcomes. Alinta Energy suggests that issue of this nature are real and measureable and are more worthy of the AEMC and the AER's attention than the proposed rule.

Reverse onus of proof and provision of information

Alinta Energy acknowledges the view of the proponent that the proposal does not create a reverse onus of proof; however, any affected participant, on reading the proposal, would conclude otherwise. The semantics of the proposal aside, the implication is that traders' bids will be inferred to not be in good faith unless the market participant can prove otherwise. This is an unacceptable proposal.

The proposal states: "if a trader makes a rebid when nothing has changed from the earlier bid, the new wording more clearly allows an inference to be drawn that the original bid was not made in good faith". Such an arrangement would ensure that trader's would be extremely reluctant to rebid based on criteria that are relevant to the market participant but rather in reference to the blunt instrument of potential enforcement against a low threshold.

The problematic nature of the proposal is exacerbated by the strict information provision criterion which attempts to limit the ability of the court to decide upon what, if any, additional information may be relevant to the proceedings or the ability of parties to furnish additional information during proceedings.

This proposal does not improve market efficiency but presents itself as a legal exercise to increase opportunities to ensnare market participants. The result will be a legal battle over whether or not the information presented is material enough in the mind of the AER. A subjective assessment from a party not exposed to the market over the view of market participants seeking to manage risk and generate revenue. The proposal is regressive and should not proceed.

Portfolio or asset basis

As a smaller market participant, Alinta Energy has some sympathy with the proposal that the AER be able to assess the intention of a generator or market participant by inference from the entirety of its bids and rebids across the generating assets for which it has substantial control or influence. This proposal would seem potentially appropriate given the nature of some participants operations. Nevertheless, the reality is this proposal is potentially dangerous and leaves itself open to subjective academic exercises in the absence of evidence.

Where there is clear evidence of bidding or rebidding that is not in good faith it is unlikely to be reliant on an understanding of a participant's entire generating portfolio. More to the point, the regulators limited understanding of a participant's position and drivers in the market are likely to lead the

regulator to have unrealistic perspectives and scenarios conceived for the purposes of investigation that do not assist in the identification of 'issues' with rebidding.

Further, any portfolio wide concerns proposed by the AER, based on industry experience, are likely to be based on subjective interpretation of market activity and academic scenarios that may or may not be probable or even possible. Thus, in the absence of clear evidence of rebidding or bidding that is not in good faith the value of cross-portfolio assessments is likely to be fraught. This component of the proposal should not proceed.

Proponent's position on late bidding is difficult to follow

The proposal to require rebids as soon as practical, whatever that may mean and concerns over late rebidding are not the same and should not be construed as such.

Late rebidding refers to the circumstances where a generator bids close to a dispatch interval, or in the last dispatch intervals of a trading interval. Bidding as soon as possible based on new information could occur at any time and thus shouldn't be construed to be an issue that only relates to late rebidding. The reason for this is self-evident.

Some commentators seem to imply that the market requires an identified hard deadline but which time rebids can no longer be tendered (as if that wasn't presently the case; the processing time prior to the time of dispatch being the hard deadline).

The concern with late bidding and the suggestion an alternative deadline for bidding would be more favourable incorrectly makes a number of assumptions. The most evident seems to be that if generators acted quickly on material changes in information this bid wouldn't be "late" and it would allow other market participants to respond in turn. This is not appropriate for a number of reasons.

First, in a market with 5-minute dispatch intervals back-to-back for 24 –hours of each day there is never a time in which a rebid will not be made close to the occurrence of the next dispatch interval.

Second, even if a rebid was made in relation to a dispatch interval some time away, the response from other parties to this rebid would in fact create the conditions for justification for further rebidding in an efficient market closer to the dispatch interval. In other words, the closer to the time of transaction true preferences can be revealed in relation to changing conditions the more likely the market will clear at the most efficient price which may require multiple rebids from multiple participants during the lead in to that dispatch interval (however long that period may be).

The fact that all participants cannot respond to every rebid is a truism that does not contribute to understanding of the issue. Whether late rebids are permitted or there is an earlier "gate" closure as occurs in some markets, someone has to be the last participant to respond to evolving market conditions at that last available point in time.

With a gate closure, say half-hour in advance of the dispatch interval, efficiency would be impeded as all information would not be taken into account up until the time of the transaction. Nonetheless, with a gate closure arrangement someone still has to be the last participant to bid and other participants cannot respond to this. Thus, if an arbitrary hard deadline was implemented there would be no value from an efficiency perspective in implementing such a deadline before which rebids can no longer be submitted or by when information can no longer be utilised for the purposes of justifying a rebid.

Third, the discussion on late bids continues, and this matter has been raised a number of times over the life of the NEM, as if the market operates in 5-minute blocks and that these series of one-shot games do not impact or effect one another. This is not correct.

Each dispatch interval feeds into a relevant trading interval, hourly experience, day, month, years and so on. Market participants respond and take action and manage risks in response to this learned experience. Traders' experiences and management team expertise is used to respond to evolving market conditions in a dynamic fashion. Thus, any limits on the ability to respond are likely to impede efficiency.

Therefore, if late strategic bidding is the primary issue raised by the proposal there is no justification to proceed with the proposal.

Known conditions and circumstances

The issue of timing and an appropriate time to rebid is especially subjective and any obligation placed on market participants will be artificial, efficiency reducing and legalistic for no discernible benefit to consumers or market transparency.

The proponent's rationale for an 'as soon as possible' threshold is poorly constructed, in that it presupposes that information is somehow material at a point in time, at which time a decision to bid or rebid is made, and following that single occasion that information somehow becomes irrelevant. Markets are far more dynamic than this with participants revisiting and reinterpreting information on an ongoing basis.

For example, imagine a circumstance where a generator has bid at prices that would not have been offered had outcomes late on Day 1 been expected in advance. And that outcomes when revealed through dispatch did not correspond with available information prior to each dispatch period late on Day 1.

To respond, the generator adjusts their bidding profile in response to Day 1 outcomes for Day 2 despite pre-dispatch not suggesting actual outcomes similar to Day 1 for Day 2 (which was the case prior to Day 1 on Day 0). Then, on Day 2 it becomes apparent that Day 2 is not tracking Day 1 (unexpected) outcomes and thus the same dispatch outcome is unlikely to be reached and information for Day 2 is in fact accurate (which was not the case for Day1).

Information for Day 1 has given rise to a view that information for Day 2 may be materially different enough from outcomes for a generator to wish to rebid Day 2 (even though they elected not to rebid on the Day 1). But that same information, which has been used to subjectively conclude that Day 2 outcomes may differ from available information, based on the Day 1, may ultimately prove incorrect. In this circumstances a trader's rationale for rebidding Day 2 will no longer stand and that trader may wish to rebid Day 2 again to reverse the early rebid even though there has been no material change in circumstance.

In this example, one piece of information was relevant for three different decision points over three time frames. Decision point one was the decision not to rebid throughout Day 1 when it became apparent that outcomes differed from market expectations at dispatch. Decision point two was the decision to rebid early on Day 2, on the basis the trader believed that Day 2 was unlikely to unfold as expected based on market data. Decision point three was the decision to rebid later on Day 2 on the basis the trader's expected deviations from pre-dispatch now seemed unlikely to occur.

Based on the proposal, on each occasion the trader needs to consider what would be permitted to be seen as in good faith, and that would depended on whether the information was considered material and whether the time between the information and the rebid was appropriate.

In this scenario the two Day 2 rebids contributed to market efficiency whereas the decision not to rebid on Day 1 arguably did not contribute to market efficiency. However, under the proposal it would seem that rebids on Day 2 would be subjected to significant scrutiny as there has been no material changes in a nearby period whereas the rebids would have been permitted on Day 1 but did not occur.

It is potentially the case that the trader, in consultation with the trading team made the wrong decision to change the bids initially on Day 2 and made the wrong decision not to change bids on Day 1. Likewise, once Day 2 bids had been changed it may have been appropriate to rebid earlier as opposed to waiting. But that view, as the view to rebid based on the relevant information, is ultimately subjective and difficult to externally demonstrate.

To further enunciated the difficulty in determining the appropriateness of timing and known conditions each portfolio will view information differently, will be subject to positions and exposures outside of the energy market and will have different management and decision structures.

Additionally, participants will make assessments around what other parties are likely to do in the market to respond to evolving conditions and will respond to those actions when they are revealed. This is true of all participants, whereas the proponent seems to suggest an environment where one party is active and all others remain passive and unable to respond to market developments and rebids. This is not correct.

Materiality

Alinta Energy does not support the view that all rebids should be made with reference to AEMO data. While AEMO data is invaluable it is often an input into a participants own analytical tools and processes. It is internal systems and analysis that participants utilise in order to gain competitive advantage and in order to better protect their commercial interests. Alinta Energy makes reference to a wide range of information sources and internal and external analyses.

For this reason, Alinta Energy supports a wide interpretation of materiality and any step to limit the reading of materiality will ensure that instead of traders responding to developments that participants consider material, whether subjective or objective, they will be required to second guess whether the information is considered materially relevant from the AER's perspective. This is less than ideal.

Alinta Energy strongly disagrees that this will in any way provide a greater level of certainty to the market, while it will directly undermine Alinta Energy's ability to respond to NEM developments and those in the wider integrated energy market that are relevant to Alinta Energy's position and operations.

For this reason Alinta Energy supports a wide reading of the term materiality and does not support the proposal.

However, a wide reading of materiality creates a conundrum. If any, or all, information is deemed as material, as only a market participant can deem what they consider material, then it will be relatively straight-forward to point to any change in the market, related markets, entity or competitor positions to justify a rebid. If this is the case then the value of materiality being included in the National Electricity Rules at all quickly evaporates and the wide interpretation of the good faith provisions that the proposal seems to be seeking to avoid remains the status quo. Alinta Energy believes this is appropriate.

Any other outcome only leads to a circumstance where the regulator needs to hold a view on appropriate rebids and inappropriate reasons for rebids and again moves the market towards the murky thinking of 'good' and 'bad' volatility. This approach is not appropriate in a devolved energy market.

In effect, Alinta Energy is suggesting that allowing participants to price their generation, including at times of scarcity, as they best see fit has been proven not to be matter of concern for the market given its highly competitive and dynamic nature and that there is little justification to amend the National Electricity Rules along the lines conceived by the proposal.

Further, in the absence of significant barriers to entry, and given the low returns being experienced across the market, the ongoing focus in some quarters on rebidding and bidding is an inappropriate diversion of resources away from the more significant issues facing the market and in the interests of consumers.

Five-minute dispatch and 30-minute settlement (5/30)

The 5/30 issue is one that generates significant interest amongst market participants as it does give rise to a number of anomalies that in a perfect world, and were there no limits on market design, it would be unlikely to have been implemented at market start.

Nevertheless, a perfect design scenario continues to elude the NEM for a variety of reasons, most notably the physical and technological limitations on metering. This is without taking into account investment that has responded to the existing market structure since NEM commencement.

While in a world where implementation costs could be ignored resolution of 5/30 may be justifiable, as it currently stands, and having reviewed previous work on the 5/30 issue, there does not seem to be a strong case to move away from 5/30 at this time. This is partly informed by the view that expectations around the market behaviour in a world where 5/30 does not exist are not well developed and imply markedly different incentives on participants than is currently the case. Alinta Energy does not believe this is correct.

As it stands, Alinta Energy does not consider 5/30 to be a significant factor in strategic bidding as participants retain an incentive to generate in the face of constraints and transmission outages, and to defend contract positions, and respond to generator activity both inside and outside of an individual trading interval.

Alinta Energy is open to further investigation of 5/30 issues including analysis of the whether 5/30 has a material impact on market efficiency but does not support change at this time.

Perspectives on options provided

The suggestion that participants be disallowed from rebidding generation volume into different price bands within three trading intervals prior to dispatch is not supported by Alinta Energy. This option does not provide any noted economic efficiency advantage over the status quo and appears an optical fix to some stakeholders' perceptions of rebidding.

It may be of interest to unscheduled generation and demand response but neither of those arguments relate to economic efficiency. Indeed, bidding demand into the market and eliminating the inconsistencies around unscheduled generation would be preferable to an outcome which treats each form of technology differently and distorts price signals.

The further option, to only allow rebidding that has the effect of depressing spot prices is also problematic. It would disallow efficient rebids and potentially create perverse incentives for generators to withdraw capacity.

Interestingly, an option that has been previously ruled out, only allowing rebidding for technical reasons would appear as difficult to implement as the proposed rule as it would require a subjective assessment of what is and is not a valid 'technical' reason. Alinta Energy suggests this would again create perverse incentives and would create a high compliance burden.

Alinta Energy supports the Australian Competition and Consumer Commission's previous determination that any purported benefits of limiting bidding and restricting rebidding would come at a high cost to the market. Further, rebidding up to the time of dispatch remains appropriate given the dynamic nature of the NEM and that flexibility allows participants to best manage plant availability.

In Alinta Energy's view, restriction like those in the proposal only manage to increase the complexity of the market, introduce new and less transparent incentives and do not contribute to market efficiency.

Conclusion

Alinta Energy appreciates the opportunity to comment on the consultation paper and the work of the proponent in developing the proposal.

Alinta Energy suggests the proponent has failed to make a reasonable case for change and does not support the proposal in any form.

Should you have any queries in relation to this submission please do not hesitate to contact me on, telephone, 02 9372 2633.

Yours sincerely,



Jamie Lowe
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