FOR A BETTER WORLD

Building J, 13 Reo Crescent, Coolaroo, VIC 3048 Australia
Phone +61 3 9247 4777 Facsimile +61 3 9247 4747
Visy Industries Australia Pty Ltd ABN 74 004 337 615
www.visy.com.au

13th November 2015

Attention:

Mr John Pierce
Dr Brian Spalding
Mr Neville Henderson

Australian Energy Markets Commission

Level 6, 201 Elizabeth Street

Sydney NSW 2000

Lodgment via: AEMC Web page

REF CODE: ERC0166

Dear Commissioners,

Re: Rule Change Proposal – Bidding in Good Faith – AEMC Options Paper

Please find attached Visy Industries Australia's submission in response to the AEMC's Second Draft Determination on good faith bidding in the National Electricity Market. We apologise for the lateness of this submission and hope that it can be taken into account as part of the AEMC's review.

Sincerely,

(Royce DeSousa)

General Manager – Energy & Sustainability, Visy

Introduction

Late Rebidding Continues to Occur

Since Visy's last submission on the original Draft Determination in late June, there have been a number of price extremities in Queensland all at, or proximate to, the Market Price Cap.

Below is a table summarizing the time and extent of price extremities since the beginning of the new financial year on 1st July 2015.

Date	Dispatch Interval ending	Dispatch Interval #	Price
20-Aug-15	7:00	6	$ 13,800
5-Aug-15	19:00	6	$ 13,800
5-Aug-15	18:55	5	$ 13,800
29-Jul-15	7:00	6	$ 13,800
20-Jul-15	7:00	6	$ 13,800
18-Jul-15	22:30	6	$ 13,377
17-Jul-15	7:00	6	$ 13,800
16-Jul-15	7:00	6	$ 13,800
13-Jul-15	7:00	6	$ 13,388

Apart from the frequency of these events, it's concerning that of the nine (9) five-minute events occurring since 1st July, eight (8) occurred in the very last (6th) dispatch interval and one occurred in the penultimate (5th) dispatch interval. In short, every single price extremity was late in nature. We maintain our view spelt out in all of our previous submissions, that the statistics are too strong to suggest that the lateness of these price extremities is pure coincidence. As far as the extremities since 1st July, it might be said by some that 9 does not represent a statistically robust sample set, however, it is at least curious that not one single event occurred in a mid or early dispatch interval.

Our conclusion, since prior to the commencement of the good faith bidding rule review process, is that late rebidding is deliberately occurring as a means of driving extreme price outcomes which are so late that other parties cannot respond.

Certainly the above recent events saw the shutting out of response by other competing generators and prevented users from responding to the price with load curtailment.

Large Users concern with late rebidding

Visy has not been alone in its concern with late rebidding, and in this instance, the impacts in Queensland. The Energy Users Association of Australia or EUAA (a body which Visy is independent of) has separately determined that generator bidding in Queensland and SA and related price outcomes are unacceptable.

Separately, the largest Aluminium smelter in Australia, Boyne Smelter has raised serious concerns with bidding practice and the impacts on prices

Boyne Smelter (Pacific Aluminium) concerns

Boyne Smelter, with a nominal load of approximately 950 MW, is an enormous electricity consumer. Interestingly, the majority owner of the smelter, Pacific Aluminium, is also a major shareholder in the Gladstone power station.

Pacific Aluminium has made a number of public statements on electricity prices in Queensland and recently made submission on the AEMC's Second Draft Determination. In its submission it pointed to concern with the impact of late rebidding in general across the whole NEM and in particular in Queensland.

Pacific Aluminium has pointed to the potential shutback of some 185MW in smelting capacity due to inability to secure an affordable power price for this portion of its production. Visy's concern is that if such a large load in Queensland with presumably very large bargaining power is unsuccessful in negotiating a reasonable and affordable price, there is no hope for other smaller users in attempting to negotiating a reasonable electricity price.

QLD late rebidding impacts - contract price differential to other regions

Pacific Aluminium points to the extreme separation in contract price between Queensland and NSW and Victoria driven by late price events. Visy strongly agrees with Pacific Aluminium's assessment in particular noting NSW and Queensland have a similar profile of base load generation which is underpinned by black coal with similar cost structures - given this, it is especially concerning to see yawning gaps between NSW and QLD wholesale electricity contract markets.

At the time of writing this submission, Q1 -2016 and Cal-2016 Swap and Cap[1] contract prices offered in the ASX Futures Exchange are as follows:

- Q1-16 Swap: QLD **$99/MWh**; NSW **$48/MWh** – QLD offering at a **106% premium** to NSW
- Q1-16 Cap: QLD **$43/MWh**; NSW **$7/MWh** – QLD offering at a **514% premium** to NSW
- Cal-16 Swap: QLD **$64/MWh**; NSW **$47/MWh** – QLD offering at a **36% premium** to NSW

[1] Visy refers to Q1-2016 and Calendar 2016 contracts as these contracts are the two quarter and Calendar year contracts which are the most imminent in terms of settlement. Swap contracts are contracts for fixed price (spot price is exchanged for fixed price) and Cap contracts are call options for spot price above $300/MWh are the most liquidly traded futures contracts. Cal-16 Caps specifically, however, are not liquidly trading at present with no offers currently public in either QLD and NSW so no data is presented for Cal-16 Caps. Quarter 1 prices tend to be higher than Calendar prices as it is in Quarter 1 (January to March) that volatility is perceived generally to be most extreme

As indicated above, both NSW and QLD have fundamentally the same baseload power supply and QLD has no shortage of supply with multiple baseload stations mothballed. As Ernst & Young assessed in its recent report for the AEMC, definite increases in QLD contract prices have certainly been the result of late rebidding.

Late rebidding and questionable generator bidding behaviour - a QLD only issue?

Some have suggested that late rebidding and questionable bidding behaviour is an issue only in QLD and if questionable bidding behaviour can be addressed by the QLD Government (as the owner/operator/off-taker of the power stations) then there is no issue to address in the National Electricity Rules.

Visy rejects this contention categorically. We see the potential for this kind of bidding behaviour to occur in other regions. The same worrying signs are emerging in NSW for example that large entities owning large power stations have either mothballed or announced the planned mothballing of large foundation generating units. Visy notes that prior to the onset of persistent questionable bidding activity in QLD by certain generating entities, the same entities first mothballed stations creating an apparent shortage in available capacity.

Some of the owners of large stations in NSW also hold significant other generating units in NSW and also hold strong market positions in Victoria and QLD. In the same way that QLD Government generators have had special market power driven by size, but also by strategic positioning of individual generating units, the same profile is emerging in other regions.

Visy cannot of course be categoric that late rebidding will occur in NSW in the coming few years however the risk that such behaviour will occur certainly exists and is material.

QLD Generator bidding behaviour an issue for the QLD Government or the ACCC to solve?

Late rebidding activity and price extremities have been persistent for quite sometime in QLD, and despite the impacts for electricity-consuming sectors of the economy in QLD, so far the QLD Government does not appear, at least publicly, to have taken a strong stance about bidding behaviour with its generators.

It has also been suggested by some that since there is significant market power concentration in QLD Government-run generators and that this is the reason that late rebidding is occurring, it is solely the ACCC's responsibility to solve what they claim to be purely a market structure and market power problem.

However, the ACCC has effectively said that it has no jurisdiction over QLD Government-run assets and it's Visy's understanding that the ACCC is powerless to, for example, force the divestiture of some generating units or, prevent further consolidation of two generating entities into one (as was previously announced by the Government as a possibility).

The ACCC, concerned by bidding behaviour of certain generators, has also recently suggested that it would target any collusive behaviour by QLD Government-run generators, CS Energy and Stanwell. While it is telling that the ACCC is alert to the likelihood of market power abuse by these generators, it's questionable whether the ACCC would be able to demonstrate and prove collusive behaviour in this instance - in Visy's view and in the view of many others, damaging deliberate late rebidding has certainly been undertaken unilaterally.

In summary, while alert to the problems in QLD, the ACCC may have limited ability to solve them and so far, there is no publicly available information suggesting the QLD Government has or will take issue with its generators about their bidding activity. In short, and given that late rebidding has the potential to sprout in other regions as described above, it is the National Electricity Rules which must be fixed to prevent this behaviour.

LNG as the reason for price spikes?

Some generators claim that Gladstone LNG is the reason for price spikes. This claim does not stand up to reason as late rebidding and resultant extreme price spikes have been frequently occurring over a period during which no Gladstone LNG was fully installed or commissioned (ie prior to December 2014).

Visy does not accept that LNG is by any means a contributor to the *reason* for late rebidding.

What Visy is concerned about with respect to LNG however is the future of electricity pricing in QLD. With LNG will come a further material increase in market power of already powerful generators. As gas is increasingly now diverted from power generators as fuel to LNG facilities as raw material, gas-fired generation will leave the power market, contracting supply and reducing supply diversity. Additionally, LNG plants are large electricity consumers and this is and will cause continued steep increase in electricity demand in QLD. In short, with the advent of LNG, supply will contract and demand will increase and the market power of baseload generators will markedly increase. The relevance of this shift that the circumstances in which late rebidding maybe effective in driving extreme late pricing will become more frequent – concerningly, the frequency of damaging high prices in Queensland may worsen further.

AEMC Second Draft Determination

Visy certainly recognises that (1) the AEMC has recognised a late rebidding is occurring and is a problem that needs to be addressed, and (2) that the second iteration of proposed rule changes would be a marked improvement on the existing rules in terms of targeting late rebidding behaviour.

Visy noted some of the strengths of the original Draft Determination in its submission on the original determination, such as the focus on whether bids or rebids are or become misleading or false. The second Draft Determination has seen further refinements by, for example, changing the onus of proof in determining whether a bid is or has become false or misleading.

Notwithstanding the identification of the problem and the <u>intent</u> behind the proposed rule changes, Visy is still concerned about the likely **<u>effectiveness</u>** in stamping out late rebidding or other bidding behaviour which is not in good faith.

<u>The Material Conditions and Circumstances Criterion</u>

The AEMC's proposed rule changes, and for that matter the existing rules, contain a "material conditions and circumstances" criterion. That is to say, if a generator can point to *material conditions and circumstances* which gave rise to it rebidding, then it is unlikely to be in breach of the good faith bidding rules or proposed changed rules.

Visy's concern with this is that, many of the *material conditions and circumstances* used by generators in the past as the basis for rebidding have been totally extrinsic to the generator or generating entity which made the rebid.

Pacific Aluminium and ERM Power in their recent submissions on the Second Draft Determation highlighted similar concerns with the *material conditions and circumstances* criterion.

Some reasons typically frequently employed in Queensland in recent times have been:

- QNI (interconnector) constrained
- (unrelated) 3rd party generating unit tripped
- AEMO 5-minute demand forecast higher than prior 30-minute demand forecast
- AEMO 5-minute price forecast higher than prior 30-minute demand forecast

All but one of these reasons were referred to in Visy's June (original Draft Determination) submission and in fact, with the nine (9) extreme pricing events that occurred since 1st July (referred to earlier in this submission) each of the above reasons was used as a generator's reason for rebidding and some were used more than once.

As pointed out in Visy's June submission, the concern with the above *material conditions and circumstances* being used as the basis of the rebid is that they are totally unrelated to the generating entity making the rebid in a physical sense – Visy's persisting concern is that these reasons point more to an augmentation of market power of the rebidding generator, as the basis of the making of the rebid, rather than anything specifically relating to the generator in any sense other than a market power sense.

For example, the QNI interconnector generally involves the separation of the QLD and NSW regions resulting in a QLD "price island" in which NSW generators are shut out from competiting. Where 3rd party generation trips unexpectedly, this is likely to create a short term unanticipated reduction in available generation thereby increasing the relative market power of generators remaining on line. AEMO under-forecasting of demand which, when discovered to be an undiscovered, puts increased pressure on remaining generation to meet demand and thereby increasing the relative market power of generators offering capacity at that time.

In summary, a *material condition and circumstance* criterion has already proven to be an ineffective criterion in terms of filtering bidding behaviour with the intent or effect of damaging competition, because, quite frequently, the material condition and circumstance is effectively an increase in the market power of the generator undertaking the rebidding. There is no reason to believe this ineffectiveness will not continue under the proposed rules given the same flawed criterion.

Visy has suggested alternative rule changes which could circumvent this problem in its June submission.

In relation to the timing element of using such reasons as the basis of rebidding, it could be said that the QNI interconnector, as an example, could constrain at any time, not just towards the end of a Trading Interval and therefore that QNI Interconnector constraint cannot be linked to late rebidding. Visy acknowledges that QNI can constrain at any time but has a strong belief that rebidding in relation to an actual or impending QNI constraint has typically targeted QNI constraint occurring 'at the right time' – that is to say, QNI constraint occur not infrequently and so a generator need only wait for a QNI constraint that falls towards the end of a Trading Interval before rebidding which could result in an extreme price outcome at the end of the Trading Interval.

<u>Requirement to maintain contemporaneous records</u>

Visy does not accept some participants' contentions that the AEMC's amended proposed requirement to create and retain contemporaneous records of their reasons for a rebid is onerous. In essence, the existing rules require that generators provide reasons at the time of rebidding and are also subject to query at anytime to provide evidence to the AER to substantiate their reasons – in effect generators ought already to be retaining records and evidence of their reasons in the case that the AER asks for this information. In practice, a number of reasons currently provided are suffixed with the letters "SL" which Visy understands to mean "See Log" meaning that many generators already maintain a contemporaneous log of their reasons which are more extensive than the short form reason they are obliged to lodge with AEMO at the time of rebid.

Proposed Refinements and Augmentation of Rule Changes

<u>Publication of reasons</u>

To the extent that the AEMC continues with the requirement for reasons for rebidding within a time window, Visy suggests that the reasons for within-window rebids should be published by the AER. This will at least allow a public focus on reasons and in this environment, a participant maybe more wary of lodging reasons which repeatedly and persistently point to a market power concentration as the basis of the rebid.

<u>Penalties</u>

Visy agrees with Pacific Aluminium's contention that penalties be strengthened given the damage to the contract market from late rebidding of some $400 million as estimated by ERM Power.

Alternatives still open to the AEMC: Gate closure for re-bidding

As Visy has maintained since the early days of this rule change review process, gate closure presents the most effective approach to stamp out questionable late rebidding.

In Visy's June and February submissions, we spelt out legitimate exceptions to late rebidding which should be allowed including (1) safety, physical reason, (2) rebidding of volume into a lower price band, (3) some other reason where it could be demonstrated by the participant to the AER that, in essence, the rebid did not have the intent or effect of damaging competition.

Visy suggests a timeframe for gate closure that is short enough not to materially impact market efficiency but also long enough to ensure sufficient time for market and user response to rebidding. A 30 minute rolling horizon has previously been proposed by Visy (subject to AEMC issues around rolling DI gate closure horizons) and in some ways it could be said that this is a shorter horizon than the AEMC proposed reasons / reporting timeframe of 15 minutes prior to the following trading interval (effectively a maximum 45 minute horizon).

International Jurisdictions – Gate Closure is the norm

As was borne out in the extensive review conducted for the AEMC of properly functioning and well-established electricity markets around the world earlier this year, ***ALL 6 other jurisdictions reviewed have gate closure***.

Notwithstanding earlier proposal of gate closure by the AEMC, it has been discarded in recent reviews but this goes against the body of international experience identified by the AEMC in its review of markets globally.

Unintended consequences of Gate Closure?

Visy is aware of reference to supposed "unintended consequences" of gate closure and negative impacts for market efficiency.

Visy recognises the importance of legitimate rebids close to the time of dispatch such as physical (safety/technical) issues or the desire to bid volume into a lower price band but apart from accounting for these exceptions, Visy has not heard of, nor can it see any description by any respondents to the AEMC's rule change review of genuine and material unintended consequences. In fact Visy has asked market participants as well as government agencies what they consider to be likely unintended consequences and so far, Visy has not received a response with substantive merit.

As spelt out in prior submissions, provided legitimate rebids are excepted from bidding "lock-out"and that the timeframe for gate closure is not protracted and merely ensures adequate response time for other participants, gate closure is likely to be effective in stamping out questionable late rebidding – this is evidenced by the weight of other jurisdictions properly functioning with gate closure in place.

Visy is strongly of the view that, while the AEMC has proposed a number of amendments to the good faith bidding provisions which should be implemented to target questionable bidding behaviour generally, the key to an effective response to late rebidding, is gate closure with appropriate exceptions.