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**Market Design and Regulatory Affairs**

Your ref. ERC0166  
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Swindon, UK, 10 June 2015

Dear Mr Pierce

**Further Submission on Draft Determination: National Electricity Amendment (Bidding in Good Faith) Rule 2014**

RWE Supply & Trading (RWEST) very much welcomes the opportunity to comment on AEMC's draft determination of a more-preferable rule in respect of the National Electricity Amendment (Bidding in Good Faith) Rule 2014.

RWEST agrees with the AEMC that the draft rule will, or is likely to, better contribute to the achievement of the National Electricity Objective than the existing rule and the proposed rule. AEMC's proposed more-preferable rule, the associated evidential standards and the requirements for rebids to be timely and make "reasonable" representations provides significant improvements over both the current rule and the proposed rule. RWEST would, however, suggest that the text of the rule is modified slightly to clarify further the ongoing nature of the representations made by bids and offers. RWEST also supports the proposal for late bidding reports. It is essential, however, that these late bidding reports are accompanied by greater public transparency and scrutiny of the reports if the new rules are to be effectively policed.

While RWEST supports the more-preferable rule, it remains relatively limited in scope. RWEST would therefore continue to recommend that the prohibition on false and misleading offers and bids forms part of a wider framework for market integrity and transparency to cover market manipulation, insider dealing and behaviour covering both the physical and the associated financial markets.

I hope RWEST's comments are helpful in finalising the rules and please do not hesitate to contact me if you would like to discuss any aspect of our response further.

Yours sincerely



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# RWE Supply & Trading Submission on Draft Rule Determination: National Electricity Amendment (Bidding in Good Faith) Rule 2015

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## 1 Summary and Overview

RWE Supply & Trading (RWEST) very much welcomes the opportunity to submit comments on AEMC's draft rule which is a more preferable rule governing bidding and rebidding in the National Electricity Market (NEM).

AEMC has thoroughly reviewed the submissions and has come to a well-reasoned conclusion. While the draft proposal falls short of the more far-reaching changes that RWEST advocated in our response to the Options Paper,<sup>1</sup> RWEST agrees with the AEMC that the draft rule will, or is likely to, better contribute to the achievement of the National Electricity Objective than the existing rule and the proposed rule. AEMC's proposed more-preferable rule strikes a balance between allowing prices to be set by competitive forces and the need to ensure that bids accurately reflect dispatch intentions and are not false and misleading. The increased evidential standards and the requirements for representations and the timeliness of rebids to be "reasonable" also provide significant improvements over both the current rule and the proposed rule. RWEST would, however, suggest that the text of the rule is modified slightly to clarify further the ongoing nature of the representations made by bids and offers.

RWEST also supports the proposal for late rebidding reports. Concerns relating to late rebids, and particularly those within the trading interval, are sufficient material to warrant further scrutiny of the reasons for those rebids. In the absence of a hard gate closure ahead of the trading interval – as we advocated – it is appropriate that such bids are subject to higher evidential standards. It is also essential that these late bidding reports are accompanied by greater public transparency and scrutiny of the reports if the overall "reasonableness" of these reports is to be effectively policed. RWEST believes, however, that the case for a hard gate closure and the resolution of the 5-30 anomaly remains and that this issue deserves further consideration.

RWEST continues to believe that the Commission should adopt further measures to complement the prohibition on false and misleading offers. While the more-preferable rule offers a significant improvement over the status quo and the proposed rule, it remains relatively limited in scope. The rule will do nothing to address wider concerns about market abuse, integrity and transparency. We would therefore recommend that the prohibition on false and misleading offers and bids forms part of a wider framework for market integrity and transparency to cover market manipulation, insider dealing and behaviour in both the physical and the associated financial markets.

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<sup>1</sup> RWEST Submission to Options Paper: National Electricity Amendment (Bidding in good faith) Rule 2014, RWEST, 6 February 2015.

## 2 The proposed behavioural statement of conduct

The Commission’s draft rule represents a significant, but limited, improvement on both the current good faith provisions and the South Australian Government’s Proposed Rule. As noted in our response to the Options Paper, a rule based solely on the intention of the generator at the time of a bid or rebid is not capable of being tested or enforced in practice. At the same time, we recognise that efficient pricing in a real-time energy-only market requires a complex and evolving assessment of one’s expectations about emerging supply and demand fundamentals and that prescriptive pricing rules can undermine market efficiency. In this regard, the requirement under the South Australian Government’s Proposed Rule for there to be a material and objectively observable change in circumstances had the potential to be unduly restrictive in ruling out changes relating to subjective expectations that failed to materialise. The Commission’s draft rule would appear to reconcile these concerns by retaining the flexibility of the current arrangements while improving the evidential requirements surrounding bids and rebids. The following sets out our detailed thoughts on the components of the proposed prohibition on false and misleading offers.

### 2.1 The preferable rule is clearer and enforceable and will promote the efficient operation of the NEM

The proposed prohibition on false and misleading offers and bids has several similarities with the current good faith provisions. Most importantly, the rule does not attempt to prescribe what is or is not an appropriate level of any price and is based on the generator’s intention to honour the bids made. As we noted in our response to the options paper, a test based on intention alone is unenforceable in practice in the absence of clear evidence of bad faith. However, although similar in character, the AEMC’s proposed rule would appear to improve the ability to verify and police those provisions in several important respects:

- Casting the prohibition in terms of “false and misleading bids” and making the bids and offers an “ongoing representation” of generators willingness to fulfil the bids and offers is helpful. Linking this representation solely to “good faith” was unduly narrow and fails to cater for circumstances in which bids are used strategically to influence pre-dispatch schedules or become obsolete in the light of circumstances. Similarly, expanding the scope of the provision to all dimensions of bids and offers (and not just to changes in available capacity and daily energy constraints) is an appropriate extension of scope.
- The requirement to rebid “as soon as reasonably practicable” significantly strengthens and clarifies the case for bids and offers to be interpreted as ongoing representations which remain valid until circumstances – and intentions – change.
- The additional wording at 3.1.4(a)2 helpfully clarifies the uses of the bid information in informing market forecasts and expectations. This provides good additional guidance on the context and purpose of the prohibition.
- The proposed amendments to 3.8.22Ab(2) and 3.8.22A(c) move away from the need to prove a negative intention (ie, that the bid was in bad faith or deliberately false and misleading) to a more objective standard of the “reasonableness” of the basis for making that claim based on the prevailing circumstances at the time of the bid or rebid. This is bolstered by allowing the courts to infer whether a bid can be considered to be false or misleading from the generators’ patterns

of behaviour and from what market participants observed, knew, believed or intended at the time.

Taken as a whole, the package of provisions represents a significantly more robust, objective and enforceable prohibition than both the existing and proposed rule.

## 2.2 The ongoing nature of bids and rebids needs to be clarified further

The ongoing representation element of the preferable rule text could be clarified further. Both 3.8.22A(a) and (b) can be read individually and together as referring only the nature of the bids and offers at the time they are made. We would therefore suggest amending the text in (b) to make the ongoing nature of the representation clearer by the following change:

“3.822A(b) Without limiting paragraph (a) *a dispatch offer, dispatch bid or rebid* is taken to be false or misleading if, ~~at the time of making such an offer bid~~ *a Scheduled Generator....”*

## 2.3 Reasonableness judged against circumstances is an appropriate behavioural benchmark

We recognise that there is an inevitable degree of subjectivity in judging the appropriate time for it to be “reasonably practicable” for information, judgements and observed events to translate into revised expectations and intentions for the future. This generates some uncertainty as to how generators might respond and comply with these provisions and how regulators might enforce them. Good guidance on the application of the provisions and evolving case law will shed further light on the effectiveness of these provisions in practice. However, while acknowledging the importance of regulatory certainty, we would note that:

- The efficiency of the market and associated financial markets depends crucially on market participants’ confidence in the integrity of the markets. Regulatory certainty for generators cannot be at the expense of actions that undermine the integrity – and perceived integrity – of the market. The good faith provision has lost significant credibility in the light of the Stanwell judgement and, in our view, is no longer capable of being enforced. There is absolutely no benefit from the regulatory certainty that the current market behaviour rules cannot and will not be enforced; the status quo is not an option.
- At the other extreme, regulated markets provide absolute certainty by setting out exactly what cost items, information and allowances are “allowable” to feature in a bid to the market and require prices to be based on objectively observable data. The NEM is one of the least regulated energy-only electricity markets in the world and is based on an impressive and fundamental belief in the strength of competitive forces across all dimensions of the market. As the idiom goes, generators pleading for greater regulatory certainty might therefore “be careful what they wish for”. We suspect that most would prefer rule changes which seek to enhance competition through clearer behavioural rules and greater transparency (see section 3 below) rather than prescriptive and inflexible bidding rules that threaten to restrict or distort competitive responses.

- Any system based on such a fundamental belief in competitive forces acknowledges the probabilistic nature of events and the complex interactions between observed external events, market behaviours, future expectations and bidding intentions. In this context, the “reasonableness” of an intention to satisfy a bid and the timeliness of any rebids is entirely appropriate. As the AEMC has concluded, it would not have been reasonable to link rebids solely to externally observable events (as in the initially proposed rule) because this would rule out rebids stemming from unrealised expectations.

In summary, “reasonableness” is an entirely appropriate benchmark for drawing enforceable conclusions as to whether bids are false or misleading or rebids sufficiently timely. RWEST therefore supports the adoption of the more-preferable behavioural rule. However, the proposed rule is still limited to the intent to honour the bid or rebid. It does not extend to other forms of market manipulation and abuse, including setting prices at artificial levels to leverage a parallel derivatives position. We address this point further in section 5 below.

### **3 Late bidding reports will provide required scrutiny of very late rebids, but must be accompanied by increased transparency**

RWEST welcomes the proposal for a late bidding report. The report, coupled with the revised evidential standards under the behavioural statement of conduct, should lead to a meaningful increase in the ability to scrutinise and challenge late rebids which raise concerns. Although RWEST would continue to recommend a hard gate closure to limit rebids for the current and subsequent trading interval, the late rebidding period at least acts as a “soft” gate closure beyond which generators should expect increased scrutiny and evidential requirements for their bids.

We would note that at this time horizon, the majority of material uncertainties are likely to have been resolved. Consequently, any issues associated with a lack of certainty around expectations and intentions are also likely to be largely immaterial at this point in time. This will make it relatively straightforward for generators and regulators to reconcile rebid justifications with events on the ground.

It is important, however, that increased evidential requirements and regulatory scrutiny are accompanied by significantly greater public transparency over the rebid reasons. As noted above, one of the strengths of the proposed preferable rule is that it allows for a judgement on the reasonableness of the representations to the market in the light of prevailing circumstances. This “reasonableness” can only be verified against the backdrop of what others in the market observed, expected and the impact of these events on their own expectations and behaviours. It is therefore essential that the late bidding reports are published in real time and that all stakeholders – not just individual generators – have the opportunity to scrutinise, assimilate and ultimately question the reasons provided.

### **4 Gate closure would better facilitate efficient price discovery**

RWEST remain of the view that the NEM would benefit from the introduction of a gate closure ahead of dispatch or, at the very least, a restriction on rebidding during the trading interval. We

appreciate that market structure (particularly in Queensland) may be a more significant factor than the rules themselves here. We also share the Commission's view that more-restrictive market rules are not generally an effective means to compensate for competition and market structure issues.

At the same time, late rebidding is enabled by the market rules and these rules should reflect the practical constraints and boundaries on the extent of competition. While there "will always be one generator that makes the last rebid", market rules should not create a situation where it is possible for output to be re-priced without any prospect of a competitive price or quantity response. This is largely an empirical question requiring a trade-off between the likely inefficiency of drawing a line under rebids at some point in time versus the distortion associated with inefficient rebids. Most electricity markets capture this trade-off in a gate closure shortly ahead of the trading and dispatch interval.

The NEM has the further complication in that the ability to rebid dispatch periods later in the trading period – coupled with prices averaged across the trading period - effectively allows generators to re-price output that has already been dispatched. Similarly, consumers may choose to consume (or turn down) on one price early in the half-hour only to pay a different price later. This appears completely anomalous, contrary to fair market principles and inefficient.

There remains therefore a strong case for a gate closure – at the very latest at the start of the trading interval - to ensure that prices and volumes can be concluded consistently within a sufficiently large pool of potential market participants *over and above* the role that gate closure would play in restricting inappropriate rebidding behaviour. Failing that other means of resolving the 5-30 anomaly should be explored; including the possibility of shorter trading intervals and/or aligning the dispatch and trading intervals.

## **5 Wider market integrity and transparency rules are still required to bridge the gap between spot and derivative markets**

As noted above, RWEST believes that the revised behavioural statement of conduct should help to tackle one dimension of potential market abuse. However, the provisions only apply to the time dimension between bid and rebid in the physical spot market. The draft preferable rule does not address several other dimensions of potential market manipulation and abuse. For example:

- The preferable rule fails to bridge the regulatory gap between the physical market and the financial wholesale market and to tackle market manipulation through bids or rebids which are aimed at setting prices at artificial levels to leverage an open position in the associated derivatives market.
- The prohibition only relates to the bids themselves and would not cover misuse of inside information or the creation of false and misleading impressions via other means such as the dissemination of false or misleading information or the use of fictitious devices or other contrivances.

More widely, the prohibitions proposed do not directly tackle the linkage between the physical generation market and the associated financial wholesale electricity market (albeit they do touch on misleading bid information in a very narrow sense). As highlighted in our response to the Options Paper, this is a serious deficit in the current regulatory framework which threatens to undermine the development of wholesale market liquidity; increase the costs of risk management; raise undue barriers to the entry of new generators and retailers; and to distort competition to the detriment of consumers.