

Sebastien Henry
Australian Energy Market Commission
Level 6
201 Elizabeth Street
Sydney

By online submission:

22 May 2014

Dear Sebastien

RE: Bidding in Good Faith (ref ERC0166)

GDF Suez Australian Energy (GDFSAE) appreciates the opportunity to comment on the proposed changes to the good faith bidding Rules requirements, as proposed by the South Australian Minister for Mineral Resources and Energy.

GDFSAE believes that the proponent has not set out a compelling argument for making the change, and furthermore, the proposed changes would do damage to the effective functioning of the National Electricity Market (NEM). GDFSAE is therefore strongly of the view that the AEMC should not implement the requested changes.

In the sections below, we have provided a response to the questions posed in the AEMC Consultation Paper, and set out more detailed discussion of the reasons that this Rule change should not be implemented.

Question 1 - Do you consider late strategic rebidding to be the primary issue raised by this rule change request?

Strategic rebidding is an important consideration for this Rule change proposal. The inevitability that one bidder has to submit the last bid received, creates a potential for a participant to strategically aim to be the last bid prior to bid gate closure. Various measures were considered at the commencement of the NEM intended to prevent or deter late strategic rebidding, but all were rejected, as they would reduce the efficiency and effectiveness of the NEM.

Inevitably, with the nature of electricity having to be dispatched every 5 minutes, there must always be a bid that was the last one received by the AEMO dispatch systems. In some cases, it is true that this 'last bid' might be received by AEMO immediately prior to the cut-off time for any additional rebids. This theoretically gives the participant that made the last bid a level of transient market power (i.e. for 5 mins). However, it would be very difficult for a participant in the NEM to be able to ensure that its bid will be the last received, given that a number of participants could engage in a similar or opposing strategy.

The NEM is an extremely volatile EOM which relies on dynamic rebidding by participants to be effective. Late rebidding is needed to ensure efficient market operation as participants respond to volatile demand and pricing signals.

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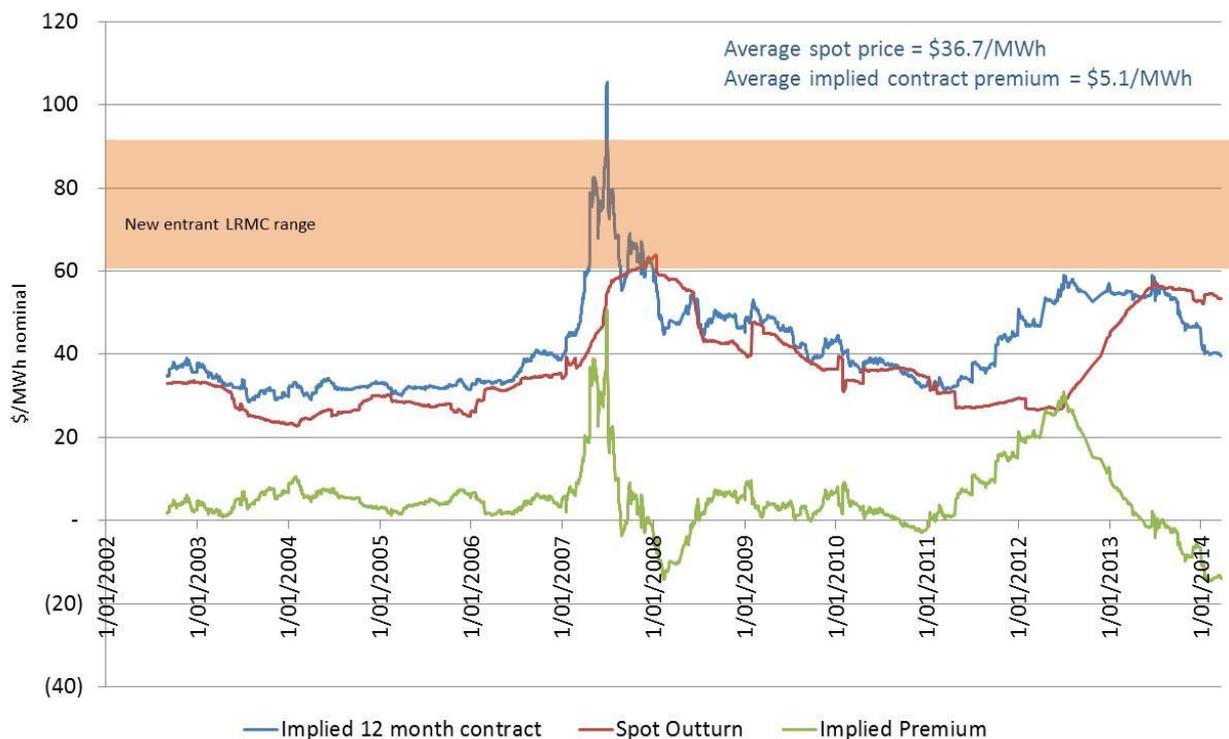
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Rebidding is particularly important to enable participants to respond to situations such as network congestion or tight supply / demand conditions. It is in these sorts of situations that it is desirable that participants are able to adjust their bids, as they respond to a dynamically changing outlook.

The level of competition in the market is such that late strategic rebidding should not be regarded as a problem that needs to be fixed. If a participant is seen by the market to be achieving an advantage due to a late rebidding strategy, then other market participants will inevitably adopt a similar strategy, or one that is intended to undermine the late rebidder. In any case, any strategic advantage gained by a late strategic rebidder will only persist for a single 5 minute dispatch interval, as the market will re-adjust with potential new bids for the subsequent dispatch interval. Any strategic advantage gained will therefore be fleeting in nature, and does not pose a fundamental issue for the market.

As the AEMC note in the consultation paper, transient pricing power is only a concern if it occurs to such an extent that it leads to wholesale prices sustained above the long-run marginal cost (LRMC) of new generation capacity. Clearly, this has not occurred in the NEM with prices well below LRMC, as highlighted in the following diagram.



Late rebidding is an inevitable consequence of a dynamic and volatile market and is evidence of a healthy efficient normal energy only market responding to price signals. Placing artificial restrictions on this would lead to inefficiencies in the NEM, and ultimately, higher costs to consumers.

Question 2 - Do you consider the NEM trading arrangements of five-minute dispatch and 30-minute settlement to be relevant to the issue of late strategic rebidding? Do you have any views as to how any issues arising could be addressed?

The five-minute dispatch and 30-minute settlement arrangements of the NEM is a relevant issue in consideration of late strategic rebidding, as price outcomes in one dispatch interval impact on the settlement price for the entire 30-minute trading interval. This can create an additional incentive for late strategic bidding, particularly in the last five-minute dispatch interval of a 30-minute trading interval.

Although it is likely that the five-minute / 30-minute issue contributes to an increase in the number of occasions that late strategic rebidding might occur, GDFSAE would be cautious about any suggested move to resolve the five-minute / 30-minute issue. Previous consideration of this issue has concluded that the costs of moving to 5 minutes settlement would likely outweigh any benefit to arise, and may create new issues for fast start plant.

GDFSAE understands that the five-minute / 30-minute issue has received some attention recently in the AEMO NEM Wholesale Consultative Committee, and that these discussions could result in a proposal to re-examine the issue in detail. GDFSAE would support a thorough examination of the five-minute / 30-minute issue from the broader context of its overall impact on the NEM, but would not support a knee jerk change in response to a fleeting and minor issue such as late strategic rebidding.

Question 3 - Do you consider there to be benefits in the proposed rule to reverse the onus of proof onto generators?

GDFSAE notes the comments made by Mr Vince Duffy at the AEMC Good Faith Bidding forum on 5 May, in which he indicated that it had not been the intent of the Rule change proponent that the onus of proof be reversed. Mr Duffy explained that the intent was for specific requirements to be placed on generators so that it would be more straight forward for the AER to determine whether or not a generator bid had been made in good faith.

Whether the proponent intended for the change to constitute a reversal of the onus of proof or not, the proposed change would recast the good faith bidding provisions in the negative, such that a generator rebid is not regarded as having been made in good faith, unless at the time, the generator has a genuine intention to honour that bid. GDFSAE believes that expressing the Rule in the negative effectively reverses the onus of proof, and creates a very poor precedent of 'guilty until proven innocent'. This is contrary to the principles of natural justice, and should therefore be vigorously opposed.

The proposed reversal of the onus of proof is especially disconcerting given the fact that the good faith provisions in the Rules carry the maximum civil penalty under the National Electricity Law of \$1 million per breach.

A practical implication of reversing the onus of proof would be that traders in the NEM would become reluctant to submit rebids for fear of not meeting the onerous requirements of specifically demonstrating good faith. The very high penalty provisions that apply to this Rule, as indicated above, would seriously compound this fear. This in turn will result in less efficient market outcomes as the number of rebids to 'fine tune' participants positions in the market will be reduced. It is likely that the reluctance to rebid would mean that some rebidding that might have resulted in lower prices would be lost.

There has already been consideration by the ACCC in 2002 on the question of reversing the onus of proof, as noted in the AEMC consultation paper. The points made by the ACCC in rejecting the 2002 proposal¹ for a reversal of the onus of proof are still valid today.

The requirement to bid in good faith provides a regulatory safety net to ensure generators do not act in an unconscionable manner. The Rule change proponent has indicated that they were motivated to suggest this Rule change because it became apparent following the AER-Stanwell court case that it would be very difficult to prove to a court that a generator had acted in bad faith. Whilst this may be a consideration, it is not a sufficient reason for a Rule change. It is entirely appropriate that the test to demonstrate absence of good faith should be onerous, as it is a serious charge which carries a very strong penalty (\$1M).

If there is a view that the requirement for information to accompany rebidding needs to be improved, GDFSAE suggests that this be done separate to and distinct from the good faith bidding requirement. This

¹ In rejecting the proposal by NECA in 2002 to shift the onus of proof onto generators, the ACCC said that the proposal had the potential to impose significant costs on participants, was not consistent with the objective 'to provide a regime of light-handed regulation', and may encourage more conservative bidding leading to less flexibility in the market.

would ensure that the “last resort” good faith bidding safety net could remain in place, with the existing very high penalty.

A further alternative approach could be that rather than the proposed Rule change which in effect defines what would constitute good faith bidding, perhaps the AEMC could include some high level principles that outline what could be considered in regards to good faith bidding. However, there should not be an attempt made to establish a regulatory definition of good faith bidding, as there are likely to be a range of circumstances that arise in the NEM which need special consideration.

Question 4(a) - Do you consider that all known conditions and circumstances should be taken into account in generator bids and rebids?

In GDFSAE’s view it is important that the existing Rule clause, which allows rebids to be made in response to changes in conditions and circumstances, be retained. This ensures that the market traders’ are able to utilise their skills and experience in trading in the NEM to respond to these dynamic changes in conditions and circumstances, and bring about optimum market outcomes.

GDFSAE does not support the proposal to limit what can be considered in deciding whether there was a ‘material’ change in circumstances, as this would lead to participants not being able to actively rebid to optimise their position which in turn, would lead to inefficiencies in market outcomes.

Question 4(b) - Do you consider the proposed rule to be practical and sufficiently clear as to when a generator must rebid following a change in material conditions and circumstances?

GDFSAE is unclear exactly when the requirement to rebid would arise under the proposed changes. For example, suppose that a trader has submitted a bid which is sensitive to wind speeds and demand in South Australia. Suppose that over the course of the next 3 hours, there are a number of changes to forecast information, with wind generator forecasts steadily increasing, and demand forecast steadily decreasing. Each of the information updates in isolation might be regarded as ‘minor’ and therefore not warrant a rebid. However, after a number of successive changes, the trader might reach a threshold at which a rebid would be necessary (or desirable). At what point in this sequence is the requirement to rebid triggered?

A further question is whether the trader would be expected to record all of the forecast changes that lead to the ultimate rebid, or only the change immediately prior to the rebid?

Question 4(c) - Do you consider that rebids should only be limited to the occurrence of a significant change in conditions and circumstances? If so, how would this be achieved in practice?

GDFSAE does not support an approach that would limit rebids to be in response to explicit and defined information such as the AEMO forecasts. Market participants employ expert staff in their trading teams to utilise their knowledge and skill in understanding and anticipating what the market outcomes might be on any given day. This requires traders to take into account a wide range of information, not just limited to the standard published market forecasts.

A trader’s reasonable expectation of how other market participants might respond to changing market conditions is an important mechanism that enables the market dynamics to converge towards an efficient outcome.

Question 5 - Do you consider it reasonable that all bids and rebids should be made with reference to published AEMO data?

GDFSAE does not support this proposal. As set out above, traders should be able to draw on a range of information, data and expectations. This is fundamental to a healthy and dynamic market.

Placing restrictions on all traders so that they are constrained to simply respond to published AEMO data updates reduces the market to a linear process, where all traders must apply tunnel vision to a single data stream. This is counter to the concept of a genuine open market, in which participants are free to choose how they offer their product.

Question 6(a) - What are your views on any of the options discussed above? Do you consider any of these options or any other options around the design of the bidding process to better address the issues raised in the rule change request?

GDFSAE believes the key point is that the proponent has made no clear case for any change to the good faith bidding provisions.

The unavoidable need to impose gate closure on rebids at some point prior to dispatch inevitably requires a level of compromise between allowing all participants to respond to late rebids, and enabling efficient market outcomes.

Rebidding is central and fundamental to the operations of the market, and any Rule change relating to rebids introduces the risk of unintended consequences. GDFSAE is strongly of the view that the rebidding Rules should not be tinkered with unless there is a clear case for change.

Please do not hesitate to contact me if you wish to discuss any aspect of this submission.

Yours sincerely,



Chris Deague
Senior Market Specialist