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22 May 2014

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

Dear Mr Pierce

Submission on National Electricity Amendment – Bidding in good faith

Please find attached the AER's submission regarding the AEMC's April 2014 consultation paper. We welcome this opportunity to comment at this early stage of the consultation process on what we consider to be an important rule change proposal.

We would be pleased to provide further assistance on this important area of work. If you would like to discuss any aspect of this submission, please contact Mr Peter Adams, Acting General Manager, Wholesale Markets, on (08) 8213 3408.

Yours sincerely



Andrew Reeves
Chairman
Australian Energy Regulator



AER Submission
National Electricity Amendment
Bidding in Good Faith

May 2014

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1 Summary

The AER welcomes the opportunity to comment on the AEMC's consultation paper in respect of proposed changes to clause 3.8.22A (Variation of offer, bid or rebid, the "Good Faith" provision) of the Electricity Rules.

All electricity market designs proscribe, in some way, certain behaviours by participants that are considered detrimental to efficient market operation. While the NEM is more laissez-faire than most other market models, relying instead on competition and quality information to deliver efficient outcomes, rebidding without a change in material conditions is prohibited. Moreover, rebidding in a way that prevents others from responding in a timely way is detrimental to achieving efficient and competitive market outcomes.

The Federal Court's interpretation of the Good Faith rebidding provision has highlighted that the current rule does not provide the desired controls on behaviour anticipated when it was introduced nor does it meet the high level policy objectives agreed to by NEM Ministers in 2002 and on which the current rebidding civil penalty is based. Ministers agreed that as a matter of policy, they:

Oppose generator bidding and rebidding strategies that are inconsistent with an efficient, competitive and reliable market, such as those not made in good faith, the blatant economic withdrawal of generation and the gaming of technical constraints.

A rebidding civil penalty of \$1 million reflected the seriousness in which Ministers considered the policy intention. Our analysis shows that the incidence of the type of bidding behaviour that impacts adversely on the efficiency of the market has increased.

The AER fully supports the SA Minister's rule change proposal. We consider the changes will more accurately reflect the original policy intent and address shortcomings in the current drafting, giving the provision the necessary utility consistent with that policy. We believe the changes will provide greater certainty for all participants, without extra burden, to enable the benefits of the NEM design to more effectively be realised.

1.1 Competition is key to efficient market outcomes

At the heart of this rule change proposal, is the desire to achieve competitive market outcomes in the National Electricity Market. A competitive market structure drives economically efficient outcomes. Efficient outcomes are achieved when the distribution of output amongst suppliers reflects consumers' valuation of the item being produced and the opportunity cost of supplying that item.

The provision of reliable and transparent information is critical to an efficiently functioning market such as the NEM.

As a security constrained, energy only, self-commitment market that allows rebidding up to the time of dispatch, the NEM relies heavily on the principles of competition. To establish an optimal equilibrium in such a market, participants need reliable forecasts against which to gauge their position and, time to respond.

The AER's analysis shows that rebidding behaviour that diminishes the reliability of the forecasts and potentially compromises competition is increasing in frequency. In particular we have seen an increase in the frequency of rebidding in the latter half of the trading interval that severely compromises the forecasts and competitive behaviours from the preceding hours and may preclude a

response from any participants not already operating. In a competitive market it is critical that market participants are able to alter their position in the market in response to changing conditions. However, when participants change their position without a clear objective reason or in order to effectively prohibit others from responding, competition and the objectives of the market are compromised.

1.1.1 Options for achieving competitive market outcomes

There exists a range of options to achieve competitive market outcomes. At one end of the range there are market designs that rely on such things as cost reflective bidding, low price caps, centrally controlled decision making and restrictive regulatory and enforcement arrangements (including energy-specific competition regulations) to ensure short-run competitive prices.

At the other end of the spectrum are market designs which allow maximum flexibility for participants to seek commercial objectives and maximise profits – this describes the arrangements that exist in the NEM. The range of options available are discussed in detail in the response to question 6 (a) in Appendix A. The NEM design relies on decentralised decision making to allow participants the greatest degree of freedom, with limited decision making by the Australian Energy Market Operator (AEMO). The price cap in the NEM is set at a sufficiently high level (much higher than other markets) to ensure that in the long run participants will be incentivised to respond to efficient market signals. As such the NEM design relies on quality and transparent information that enables participants to make rational commitment and investment decisions to achieve efficient market outcomes.

Generators are required to offer to supply energy into the NEM in good faith. AEMO accepts bids and offers from market participants, publishes forecast market outcomes and issues dispatch instructions to meet the National Electricity Objective (NEO). Rebidding is the means by which participants enact decisions on whether or not to offer their plant for dispatch and is therefore central to the efficient operation of the market. Participants can change their position right up to the time of dispatch. As profit maximisers, participants take many factors into account, for example their contract positions, fuel costs, technology, weather forecast and other circumstances in deciding whether or not it is profitable to operate.

The Good Faith rebidding provision requires participants to honour their offer to the market unless there is a change in the material conditions and circumstances upon which the offer was based. Rebids that are not made in Good Faith can adversely affect the accuracy of short-term forecast information upon which market participants rely, reducing the efficiency of the dispatch process.

As the demand side becomes more active and new generation and energy management technologies are introduced, the provision of accurate, timely and transparent information reflecting from both demand and supply side conditions will become increasingly critical.

2 Structure of this submission

The main body of this submission is essentially in two halves. The first half presents quantitative analysis on rebidding in the NEM to demonstrate the materiality of the problem. The second half discusses how the AER considers the SA Minister's rule change proposal would assist in clarifying the intention of the Good Faith provision following the Court's interpretation arising from the *AER v. Stanwell* case.

Appendix A addresses the specific questions raised by the AEMC in its consultation paper including the issue of the reversal of the onus of proof.

Appendix B addresses comments raised by the AEMC in its consultation paper regarding arrangements in the other wholesale markets.

Appendix C contains the (marked-up) text of the proposed rule change.

3 Analysis shows increase in rebidding activity

The Commission says in its consultation paper that it will assess the contribution of the proposed rule to the promotion of the NEO through consideration of the following propositions:

- *The reliability and accuracy of pre-dispatch forecasts provides price transparency, and operational and investment certainty to market participants. This leads to efficient price signals for investment and enhances the security and reliability of the electricity system in the long-term interests of consumers of electricity.*
- *The provision of accurate and reliable information to participants in a timely fashion allows for responses which are in line with the underlying conditions of supply and demand. This leads to efficient wholesale price outcomes and reduces short-term supply costs and peak capacity requirements in the longer-term, thereby lowering the price of electricity to consumers.*

Our analysis and reports have identified many instances where rebidding activity has reduced the accuracy of the pre-dispatch forecasts either as a result of participants not responding in a timely way to changes in material conditions or delaying their response to the last minute, limiting the extent to which others can respond.

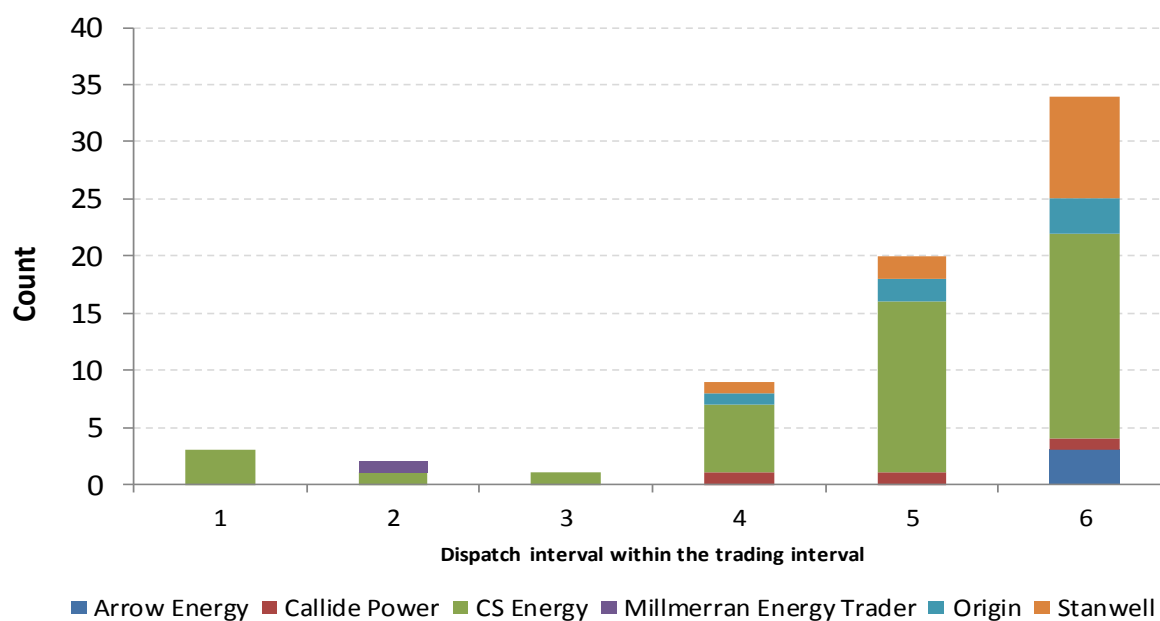
In the summer of 2013-14, there was significant price volatility in the Queensland region. We undertook detailed analysis on the drivers of this volatility as part of our Electricity Weekly report for the period ending 1 March. This analysis highlighted behaviour that produced short term price spikes (5 or 10 minutes in duration) from rebids close to the time of dispatch and/or late in a trading interval.

Effective competition relies on market participants having dependable forecasts against which their forward exposure can be assessed and sufficient time to respond to changes. The process to achieve equilibrium occurs over time and involves participants effectively settling on an acceptable position after which no further rebidding is needed. Late rebidding changes the forecast market outcomes against which participants had judged their position at the end point just prior to dispatch. This diminishes the perceived reliability of market forecasts, and effectively reduces the opportunity, or can preclude, a response from other participants. The NEM design, where dispatch is based on 5 minute targets and prices but where settlement is calculated every 30 minutes (based on the average of the six 5-minute dispatch intervals in the trading period) probably exacerbates the problem. Rebidding late in a trading interval may be profitable for some participants, but it may also impose costs on others and on consumers through inefficient dispatch. It may also drive a greater need for risk management instruments that will also result in higher prices to consumers.

Rebids become “effective” when they are integrated into the National Market Dispatch Engine (NEMDE). If the rebid is within a trading interval, new dispatch targets and forecast are issued for the next dispatch interval. If it occurs prior to that, new pre-dispatch forecasts are published. While this is usually in the next available dispatch interval after the rebid is submitted, the time it is submitted by the participant is largely controllable by that participant.

Figure 1 shows a frequency analysis of which dispatch interval in a trading interval rebids became effective for Queensland dispatch prices above \$1000/MWh associated with rebid volumes greater than 100 MW (chosen to represent a significant volume) over the 2013-14 summer. Of the 50 occasions identified, only one rebid endured beyond the end of the trading interval in which it was made. In Figure 1, if the rebid became effective in the first dispatch interval of the trading interval it is included in the “1” column, “2” if it was effective in the second dispatch interval, etc.

Figure 1: Effective dispatch interval within the trading interval for the rebids



The figure shows that most of the rebids were made within the last three dispatch intervals of the relevant trading interval. Rebids made late in the trading interval potentially reduce the opportunity for, and number of, participants that can effectively and viably react to the high price. The figure shows that over the period CS Energy, the largest portfolio in the Queensland region with the greatest capability to move quickly between price bands (based on rate of change) was, by far, the most active in rebidding very close to dispatch.

The average price in Queensland for the summer period was \$68.77/MWh. However, had the 50 short-term price spikes not occurred (in other words, excluding them from our data set), the average price would have been \$56.10/MWh, a reduction of \$14.60/MWh. This represents a wealth transfer of almost \$200m based on energy traded. In a region where the supply/demand balance is such that some units have been mothballed, this volatility is significant and will have influenced forward contract prices, ultimately flowing through to consumers' bills.

3.1 The Rebidding Index: a measure of rebidding behaviour

Following the Stanwell decision, the AER developed a measure we have called the Rebid Index (or RI) to assess the impact of rebidding on efficient market outcomes.

When forecast conditions change, and a rebid in respect of a trading interval is made well in advance of that trading interval, participants have sufficient time and information (by way of forecast updates) to react. This means that the further away from dispatch a rebid is made, the greater the likelihood that more participants can respond. With the benefit of time, and according to their own internal business drivers, participants will continue to adjust their positions through rebidding until they have reached their optimal position, thus establishing a stable market equilibrium.

The RI is a measure of how quickly the value of energy offered in participants' rebids changes within the forecast period. It incorporates the frequency of rebidding, relative changes in capacity and offer price, and a measure of the time in which a competitive response can occur.

The RI calculates the change in value of the energy shifted in a rebid, against the time to the end of the trading interval. To give some examples of how the RI works, a rebid that involves shifting

500 MW by \$10/MWh is given the same weight as a rebid that involves shifting 100 MW by \$50/MWh, but half the weight of a rebid that involves shifting 1000 MW by \$10/MWh. Another example would be a rebid that involves shifting X MW by \$Y/MWh 2 hours prior to dispatch, is given greater weight compared to an equivalent rebid made 4 hours prior to dispatch. Similarly as market information and forecasts are updated frequently, a lower weight is given to rebids made at the start of a trading interval, as the market has more time to assimilate the information and respond as opposed to a rebid made towards the end of a trading interval.

A high RI indicates a high level of change in the market, which diminishes the dependability of forecast information (as it is more subject to change). Figure 2 shows the seven day (light blue line), three month (red line) and annual (green line) rolling average indices for the NEM increasing over time. This indicates that, allowing for load growth, changes in ownership and increase in number of participants, rebidding activity has been trending upwards since July 2005.

Over the long term the RI shows a gradual downward trend from Jan 2008 to the end of 2011, but has been trending upwards ever since then. This suggests that since January 2012, forecast information has become less dependable and the ability to achieve stable market outcomes has diminished. The rule change as proposed does not change the opportunity for participants to rebid. Rather, it limits to some degree, the basis on which rebids may be justified and realigns that behaviour with the National Electricity Objective.

Figure 2: NEM Rebidding index over time

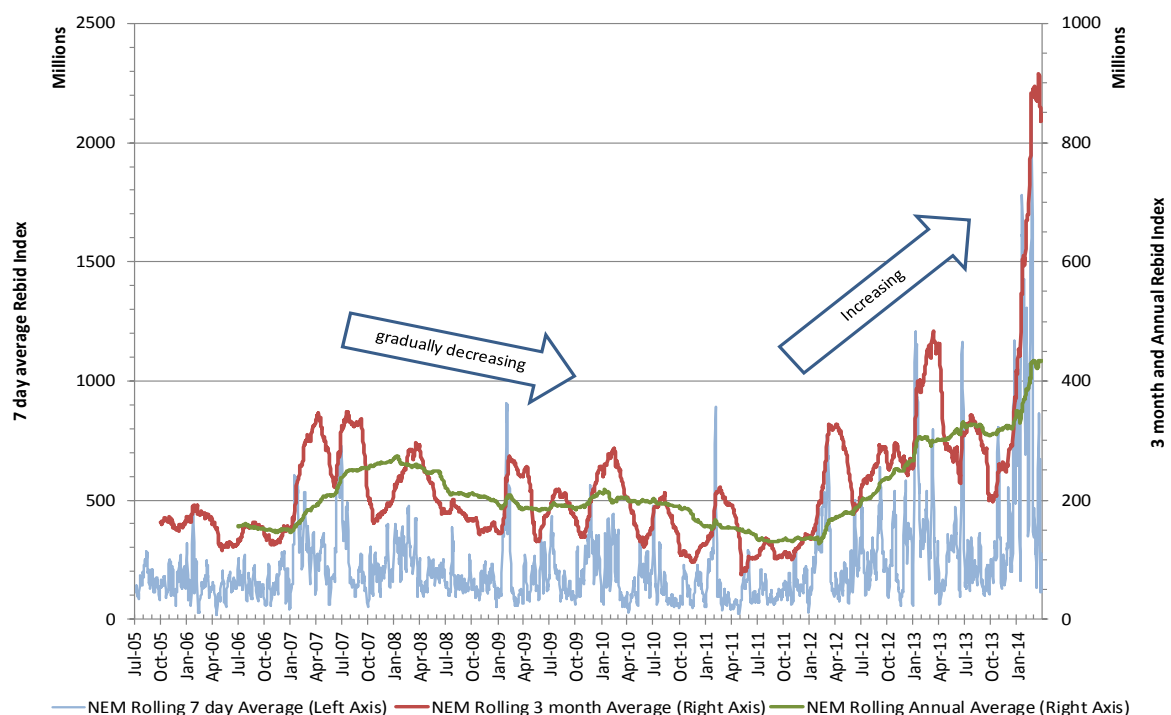
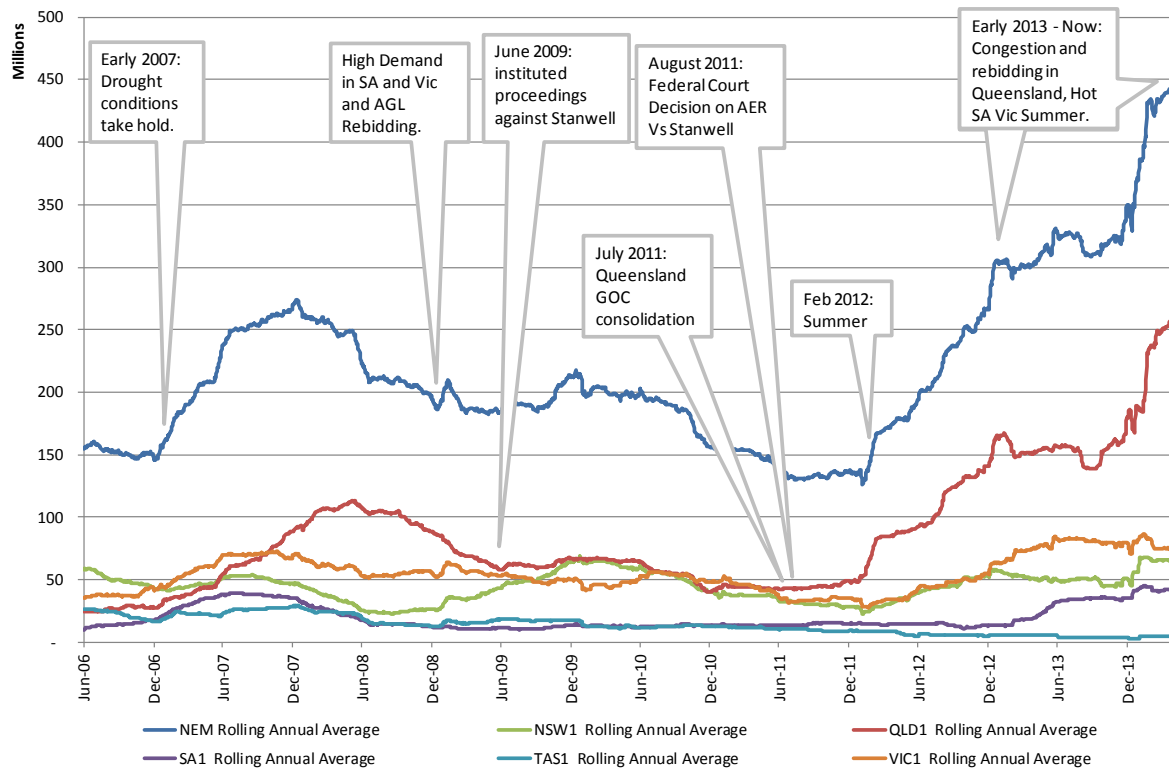


Figure 3 shows the annual average rolling RI on a regional basis. The figure shows that the Queensland RI has been accelerating and is significantly higher than other regions since December 2011. The figure also shows significant events over the period under consideration in call-out boxes. After a drop from the beginning of 2010, the RI moderated to a relatively stable level until the Federal Court's decision in the *AER v. Stanwell* matter. Since that time the RI has been trending upwards, with a marked increase since January 2012, the summer following the court decision and the consolidation of the Queensland government owned generation portfolios from three to two in the previous July. Furthermore, market events like the drought (around 2007) impact on the index, as

during these periods generators shift capacity around more frequently as new equilibriums were established.

Figure 3: Annual Rolling Average NEM and Regional rebid index



The regional curves highlight the contribution by generators in each region to the NEM RI. The RI for Queensland, New South Wales and Victoria has been increasing since the beginning of 2012.

Building on the analysis in the Special Report on Congestion and in the spotlight for the Electricity Weekly report ending 1 March 2014¹, we analysed the RIs for relevant participants in the Queensland region. Figure 4 shows the 28 day rolling average for the Queensland region and in particular participants CS Energy and Stanwell for the period January 2012 to April 2014. These participants were named in our reports as contributing to high price events during these periods.

¹ Both available at www.aer.gov.au

Figure 4: 28 day Rolling Queensland, CS Energy and Stanwell Rebidding Indices

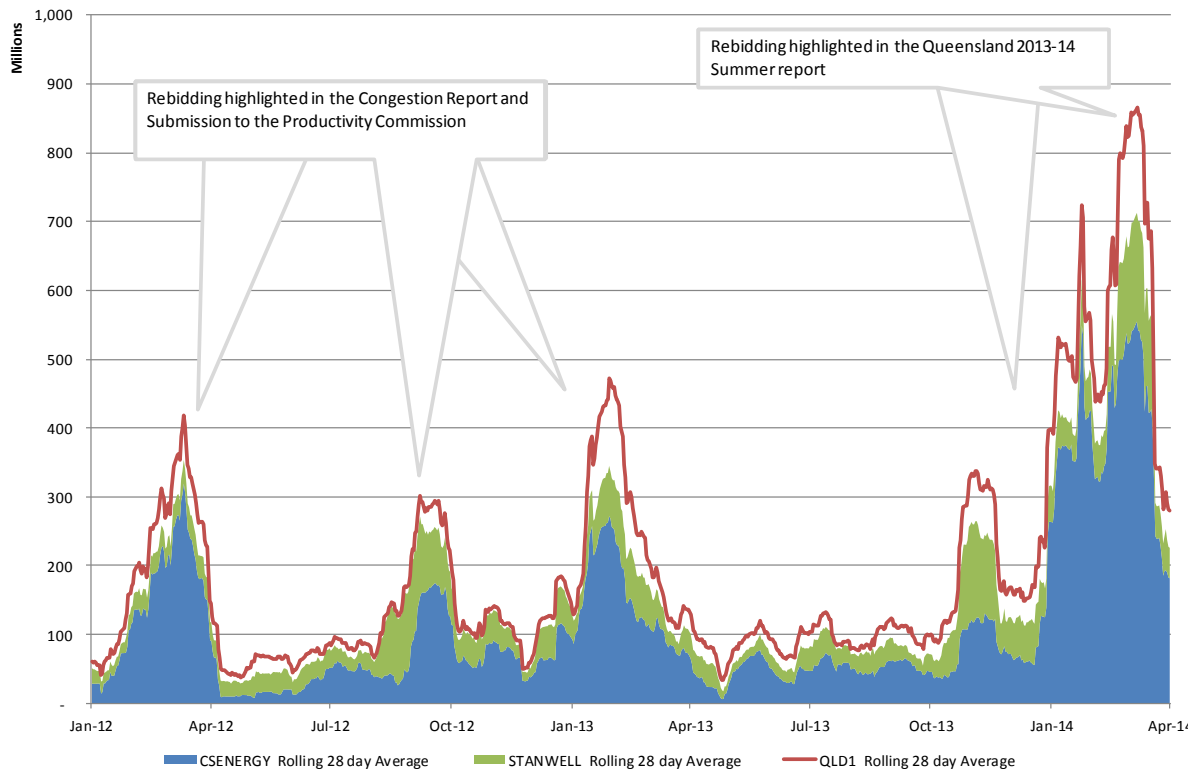
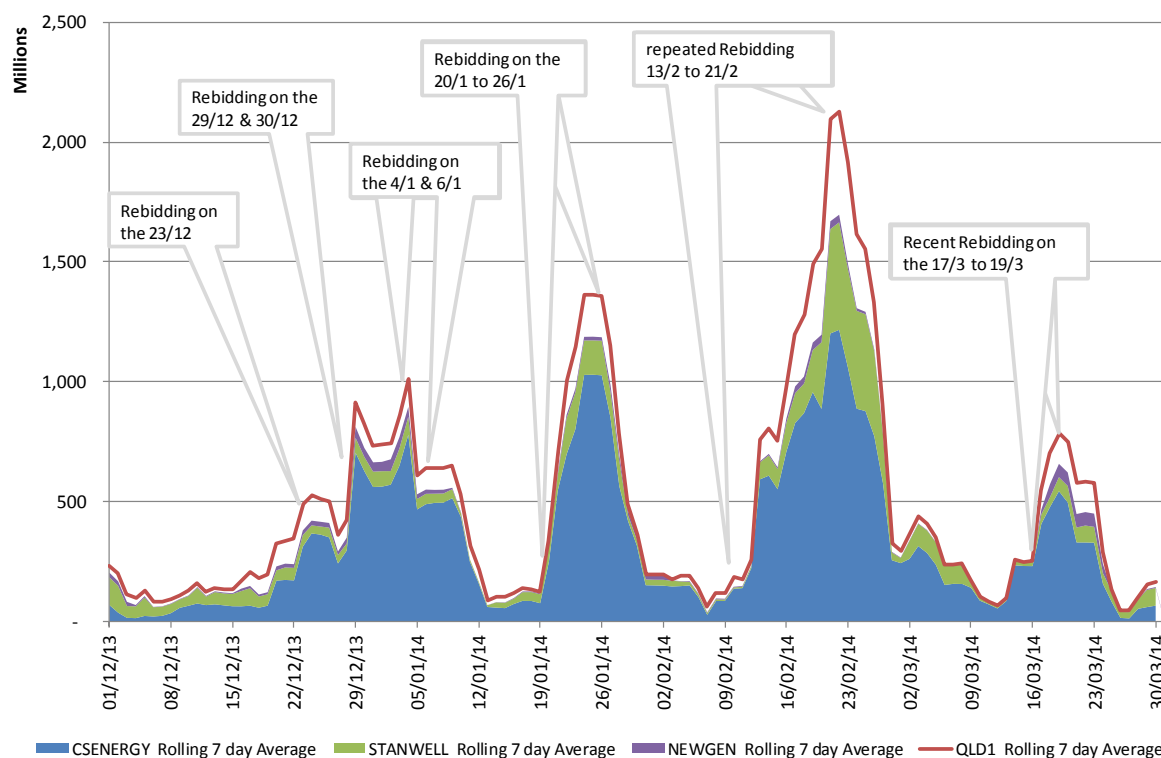


Figure 5 shows rolling seven day average RIs for the Queensland region and three participants, CS Energy, Stanwell and NewGen (Alinta) for the summer 2013-2014 period. Frequent rebidding, particularly late in the trading interval, was a significant driver of high spot market prices in Queensland in that period and shows as elevated rebid index values for the participants that engaged in that behaviour. It is clear from the figure that while NewGen responded to the changing conditions in the region their rebids were smaller.

Figure 5: Queensland, CS Energy, Stanwell and NewGen Rebidding Indices Summer 2013-2014



3.2 Analysis Conclusion

The RI shows that rebidding activity has increased markedly since 2011. As described above, this means that the market is becoming less firm and participants are less able to rely on forecast information to make informed decisions. This is detrimental to efficient market outcomes.

This, in conjunction with the results of other analysis presented in this submission, shows that rebidding late in a trading interval (limiting a competitive response) is contributing to high price outcomes, which do not necessarily reflect the underlying supply-demand conditions.

We consider that the above shows that the type of rebidding that is detrimental to efficient market outcomes has increased over time, especially recently, demonstrating the materiality of the problem and supporting the need for changes to the Good Faith provision.

4 The proposed rule change addresses problems with the existing clause

There are a number of problems that limit the utility of the rules, as discussed below. These problems have been illustrated by the Federal Court's interpretation of the existing provision in its decision on the *AER v. Stanwell Case*.

The AER instituted proceedings on 28 July 2009, alleging that Stanwell Corporation Ltd had breached the Good Faith provision of the Electricity Rules. The AER alleged that on particular days, Stanwell traders made a number of rebids that were not in good faith. On these days, the spot price in Queensland exceeded \$5000/MWh on several occasions. A summary of the market outcomes from those days was published by the AER as part of a Spot Prices above \$5000/MWh Report.

4.1 Subjective intention

Currently the AER must demonstrate that participants do not, at the time of the rebid being made, have a genuine intention to honour that rebid, absent a change in material conditions or circumstances. Dowsett J considered that material condition or circumstance could include both objective data (such as a change in demand forecast) or a subjectively held expectation or belief (such as a lack of change in forecast dispatch price if one was expected). There is also no requirement that the expectation or belief is likely or reasonable.

The ability for a participant to rely on a change in any subjectively held expectation or belief provides a relatively weak obligation on market participants. Dowsett J's view that a lack of a change in a dispatch price following an offer, bid or rebid (or even the rebid itself) may constitute a material change in circumstances or conditions sets a very low threshold for the matters that market participants may rely upon when rebidding. The ability for market participants to rely on a change in a subjectively held expectation as a change in material conditions or circumstances when rebidding (particularly those that are not reasonable) is unlikely to provide other market participants with sufficient comfort that pre-dispatch forecasts are likely to be accurate and reliable.

The interpretation also presents significant evidentiary issues for the AER. To establish a breach the AER would need to provide evidence that the subjective expectation or belief of a particular trader did not change between the initial offer and subsequent rebid. This would be a significant task unless there is clear and conclusive evidence that the trader never intended to honour its bid.

The SA Minister points out in his submission:

The clause should prevent a participant from varying its bids unless it does so in response to a significant and quantifiable change in price, demand or other data published by AEMO in respect of that trading interval, or change in other material circumstances.

This is achieved in clause 3.8.22A(e). In addition, the note included in this clause to clarify that when a trader expects a change to occur following its own rebid but that change does not eventuate, that is not a change in "material circumstances".

As can be read from the quoted text, this aspect of the rule change provides the exhaustive list of reasons for a change against which behaviours can be measured; as such then this clause removes the subjective intention. The AER agrees with the SA Minister's proposed change. Essentially, by using the "not"... "unless" construct as used in proposed clause 3.8.22A(b), the clause provides an

exhaustive list of the circumstances under which participants are permitted to vary capacity across price bands. Having said that, the AER considers the proposed clause allows participants the same level of flexibility to rebid capacity across price bands, as they currently enjoy.

As pointed out by the SA Minister, the inclusion of AEMO data in the proposed clause is designed to clarify that the non-occurrence of a change in the forecast prepared by AEMO may still justify a rebid, as opposed to the non-occurrence of a subjectively expected change not occurring.

Consistent with current best practice, we would expect participants to already be keeping complete records of the reason for submitting rebids, to ensure they comply with the current requirements of Clause 3.8.22 (the brief verifiable and specific reasons obligation) and the Good Faith provision as currently drafted. The AER does not consider that the proposed requirement to only make a variation in quantity across price bands in response to a significant and quantifiable change should increase the burden on participants in terms of record keeping.

4.2 Timeliness of response

The National Electricity Rules do not currently place an obligation on market participants to respond to a change in material conditions and circumstances within a particular timeframe. The implication of this is that a participant could rebid in response to a change in material conditions or circumstances that occurred many hours earlier.

The AER considers that while late strategic rebidding, without the requisite change in material circumstances is a key issue in this rule change proposal, it is only one element that this proposed rule change is attempting to address.

The SA Minister has proposed a change that would require participants rebidding to shift capacity across price bands to rebid as soon as practicable after the change that precipitated the rebid comes to its attention. The AER supports this proposed change. We consider it would prevent generators from withholding information until the last minute and then purposely timing their rebid to remove the opportunity for other participants to respond.

The AER agrees with the analysis provided by the AEMC on pages 16 and 17 of the consultation paper. We agree that late rebidding can compromise efficient market outcomes and that productive efficiency losses can arise as a result of generation technologies deployed as a result of short-term and unsustainable price spikes. However, we also recognise that the NEM is an energy only market and that transient pricing power does arise, which, in and of itself is not necessarily undesirable.

The AER concurs with the AEMC's assertion that aspects of the design of the NEM bidding process and trading arrangements may exacerbate the incentive for generators to engage in late strategic bidding. However, the consultation paper also states that:

An optimally efficient outcome should generally be expected to occur when, for a given set of market conditions, individual participants do not have an incentive to further adjust their price/volume offers.

Based on the AER's analysis and discussion with a number of stakeholders (both on the supply side and consumers), this has not been the case, as the optimal short-term equilibrium is often not being reached due to insufficient time to respond. This was particularly the case during the recent summer in Queensland.

Late strategic bidding by participants in Queensland from December 2013 to the end of February 2014 was the subject of detailed analysis by the AER, and was published in our weekly report covering the period 23 February to 1 March. The analysis examined the impacts of rebidding close to dispatch, in particular rebidding late in a trading interval, as explained in more detail in Section 3.

4.3 Portfolio bidding

Participants seek to maximise profitability across their entire portfolio of assets. This could involve many production centres, in varying locations, and many more individual scheduled generators. The current drafting of the Good Faith provision requires an assessment based on bids and rebids related to a single scheduled generating unit, rather than a power station or a participant's entire generation portfolio. The implication of this is that in reviewing compliance with the Good Faith requirements, the participant's behaviour must be assessed by comparing rebids on a unit by unit basis, without taking into account how a portfolio of generators under the control of a participant is being optimised.

In order to achieve a particular objective, a rebid submitted in relation to one scheduled generator is often immediately followed by a rebid on a different generator within the same portfolio. Under the current drafting these are considered separately despite potentially being lodged by the same trader responding to the same business imperatives.

The SA Minister has proposed a change to clause 3.8.22A(c)(2) that would enable the AER to ascertain by inference, based on other rebids made by the participants, over which it has control, that a particular rebid was not made in good faith.

4.4 Information available to the AER

The SA Minister's rule change proposal introduces the requirement that participants must provide the AER with accurate and complete data and information to substantiate that a bid in relation to available capacity and daily energy constraints is made in good faith.

The AER supports this proposal. As explained in the SA Minister's rule change proposal, under the section entitled *Genuine Intentions*, to prove a breach of the Good Faith provision in its current form, the AER must prove that the relevant trader was placing bids that were never intended to be honoured. This implies that for the AER to monitor compliance with the rebidding provision, they need information regarding an individual trader's state of mind.

In the Stanwell case, the Court placed particular weight on the trader's testimony. This testimony was not entirely consistent with previous information provided by Stanwell to the AER through formal information requests including information gathering powers under section 28 of the National Electricity Law (NEL).

In the absence of powers to interview parties, the AER considers that the inclusion of proposed clause 3.8.22A(d) would assist in addressing this problem.

Further analysis of the proposed rule change, based on the questions posed by the AEMC is addressed in Appendix A. Full details of the proposed rule change submitted by the SA Minister and referred to above are included in Appendix C.

The AER supports the SA Minister's rule change proposal. We consider it will help to meet the high level policy objectives agreed to by NEM Ministers in 2002 and on which the current rebidding civil penalty is based. As evidence of the importance of this policy intent, the Good Faith provision is the

only civil penalty provision in the Electricity Rules to attract the maximum penalty of \$1 million. The AER is of the view that the changes would give the provision the greater utility consistent with the policy, and, most importantly we consider they would deliver benefits to the market through providing market participants greater confidence on reliable forecast information.

5 Appendix A: Responses to questions raised in the consultation paper

Question 1

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

While we consider this to be a significant issue, it is only one of the issues this rule change request seeks to address.

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?

Yes, as discussed under section 3 (Analysis), the five-minute dispatch and 30 minute settlement can exacerbate the problem of late strategic bidding. The rule change proposal will clarify bidding behaviour that should reduce the number of late rebids but will not resolve the 5-30 minute settlement issue. Resolving the Good Faith submission will substantially support effective market operation independent of the settlement arrangements.

Question 3

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

The AER considers that the redrafting of clause 3.8.22A(b) does not reverse the onus of proof - instead the redrafting provides an exhaustive list of what is permitted in order to satisfy the Good Faith provision.

Whether the rule change proposal involves a reversal of the onus of proof, is a matter of legal construction. Such matters begin and end with the text of the provision, always read in context and legislative purpose.

According to the consultation paper, the characterisation of the rule change proposal as involving a reversal of onus of proof rests on the addition of the word “not” after the existing phrase “.....rebid is taken”, and the change of the word “if” to “unless” in clause 3.8.22A(b).

We do not consider the text of clause 3.8.22A(b) to be legally effective to reverse the onus of proof. Nor do we consider it imposes any evidential burden before the AER adduces evidence sufficient for the court to draw the inference that clause 3.8.22A(a) has been breached, on the balance of probabilities.

Further, we understand that courts do not readily find a statutory intention to reverse the evidentiary burden or persuasive onus. In light of the absence of any clear statutory purpose imposing an onus or evidential burden on the Generator as to the underlying factual question of whether or not the genuine intention is present or lacking, the AER will be regarded as having the burden of leading evidence on that matter.

Importantly, the amended clause 3.8.22A(b) does not: refer to court proceedings; expressly place an evidential burden or onus of persuasion on any party in any such proceedings; or provide that the court is to treat the requisite genuine intention as lacking unless the Generator proves, or adduces some evidence, to the contrary. In these respects clause 3.8.22A(b) differs markedly from provisions such as previous s 51A(2) of the Trade Practices Act 1976 (Cth) (TPA), s 4 of the Australian Consumer Law, certain State Fair Trading Act provisions on the same topic as s 51A(2) of the TPA (e.g. s4(2) and (2A) of the Fair Trading Act 1999 (Vic)) prior to the commencement of the Australian Consumer Law, ss 13.3 and 13.4 of the Commonwealth Criminal Code, and the original form of clause 3.8.22A(b) proposed by NECA in 2001.

All of the above examples included (or include) express reference to their application to the onus, or evidentiary burdens on certain issues in court proceedings. Each, with more or less specificity, expressly places certain burdens or onuses on a respondent/defendant.

Question 4

We would expect that participants would be monitoring the factors that are important to their business almost continually as part of their normal risk management processes. This rule change is not changing the practices that conventional risk management practices should be imposing. As such then, while each business may consider different inputs, the practice of incorporating them into a rebid or decision making process to support a rebid should not be different to those performed currently.

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

We would expect participants to be tracking information important to their business and to make rebidding decisions based on all that information. This business type of information would provide the support material against which a rebid would be justified.

(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?

Yes – as soon as is practicable after the change comes to its attention. This is discussed in detail under section 4.2 *Timeliness of response*.

(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?

It is important to note that this relates only to shifting capacity across price bands. The draft clause 3.8.22A(e) refers to a significant and quantifiable change in price, demand or other data published by AEMO or other material circumstances. How this would be achieved is discussed under 4.1 Subjective Intentions. In addition, the note to clause 3.8.22A(e)(2) clarifies that when a trader expects a change to occur following its own rebid but that change does not eventuate, that is not a change in “material circumstances”.

Question 5

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

The proposed clause (3.8.22A(e)(1)(ii)) states that rebids (in respect of shifting capacity across price bands) may also be made in response to a significant and quantifiable change in publicly available AEMO data or other material circumstances. The AER considers this provides participants with flexibility to rebid capacity across price bands in response to internal business drivers (such as, a change in contract position or other drivers), provided the change is significant to the business and quantifiable.

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?

There are a broad range of options that may address some aspects of inefficient rebidding practices, including approaches adopted in overseas energy markets and non-energy markets. These options could range from drafting amendments to the current clause 3.8.22A to address some of the specific concerns with the clause identified above, or, alternatively, proposals which significantly alter the current market design. All options would require amendments to the National Electricity Rules and would require thorough legal review.

The options considered broadly fall into four categories:

- intention based options
- outcomes based options
- structural options and
- regulatory or information disclosure options.

In some cases it may be appropriate to implement more than one option or combine aspects of several of the options. All options have advantages and disadvantages and the merits of implementing any of the possible options would require significant analysis and consultation.

Intention based options

Intention based options are similar to the existing Good Faith rebidding provision. These options involve targeting bidding and rebidding where the market participant has not had a particular intention at the time of submitting their bid or rebid. Possible reforms that could be considered include:

- defining those changes in material circumstances or conditions that a market participant may rely upon when rebidding (for example only objective changes that can be objectively verified, such as a demand forecast)
- applying an objective standard to the bid or rebid (for example permit comparison of the market participant's behaviour against a hypothetical 'reasonable market participant')

- shifting the onus of proof, such that the market participant must prove that its bid or rebid was made in Good Faith and did not breach the National Electricity Rules.

There are many variants of these options. One possible option would be to have a stricter intention-based test that applies only to rebids made within a short period of dispatch (i.e. within four hours of dispatch), but the broader intention based test for rebids outside four hours of dispatch.

The key factor that tends to distinguish 'legitimate' rebidding from other types of rebidding is the intention of the market participant at the time of making the initial offer and subsequent rebid. The key benefit associated with intention based options is that they do not prohibit 'legitimate' rebidding that may deliver benefits to the market.

However, there are a number of problems associated with these approaches. The most significant problem is the difficulty involved in enforcing and monitoring compliance with these obligations. In particular there are challenges associated with gathering sufficient evidence on the intention of the participant to prove a breach.

The SA Minister's proposal seeks to overcome some of the problems associated with the existing intention based provision by being specific about acceptable triggers for rebidding.

Outcomes based options

Outcomes based options are only concerned with rebidding that result in a particular detrimental market outcome (such as a particular price outcome). These options are often linked to addressing the potential opportunities for the exercise of market power associated with a market participants' ability to rebid.

Possible options could include:

- Prohibiting rebids that have a particular purpose or likely effect (for example rebids that prejudice the efficient, competitive or reliable operation of the market). A variation to this option is to apply these obligations only when the market is operating outside its 'normal' parameters, such as at time of extreme high demand or prices or within a short period of dispatch (for example within four hours of dispatch).
- Only allow rebidding that has the effect of depressing spot prices.

The benefit associated with these approaches is that they permit rebidding that is likely to have neutral or beneficial outcomes in the market. The drawback of this approach is that it is difficult to provide an objective standard for conduct that is detrimental to the market. These options will therefore often involve subjective assessments of the likely affect or purpose of particular behaviour. Enforcing and monitoring compliance with these options is made more difficult by the fact that outcomes in the market are the culmination of the behaviour of all market participants and it can therefore be difficult to link the actions of one participant to a particular market outcome.

Options similar to this have been implemented with varying degrees of success both domestically and internationally. In Alberta Canada, market participants must 'conduct themselves in a manner that supports the fair, efficient and openly competitive operation of the market'. The Market Surveillance Administrator (MSA) considers whether a participant's behaviour constitutes a breach of this standard on a case by case basis. The MSA also publishes guidelines which clarify how they interpret the requirement, and market participants may apply to the MSA for clarification as to whether specific behaviour is considered to be a breach.

Queensland has also previously implemented an option that allowed all rebidding that shifted capacity into lower price bands. The experience in Queensland was that this was unsuccessful in promoting efficient bidding and rebidding as generators had an incentive to bid all their capacity at the price cap and then rebid capacity into lower price bands closer to dispatch.

Structural options

Structural options would alter some aspects of current market design. They could be quite broad ranging and include:

- prohibiting all or limiting the number of rebids
- only allowing rebidding for bona-fide technical reasons
- prohibiting or limiting rebidding within a defined number of trading intervals before dispatch.

The United Kingdom applies one of these options to limit rebidding close to dispatch. Market participants may vary their contract and physical data up until gate closure, which occurs one hour before the relevant settlement period. The data which is current at the time of gate closure cannot be changed. If a participant does not adhere to their offer then they must purchase or sell the difference at the energy imbalance price. The PJM (covering 13 states in the United States and British Columbia in Canada) adopts a similar approach.

The benefit of these options is that they limit the opportunities for market participants to manipulate dispatch prices close to dispatch. They may encourage genuine initial bids and offers and result in more accurate information to the market. These options also do not rely on subjective assessments of particular market outcomes or the intention or behaviour of a market participant.

However, these types of options have a number of drawbacks. The most significant drawback is that they may not encourage efficient market outcomes as it applies to all forms of rebidding. Rebidding is a key element of current market design because it allows the market to balance supply and demand efficiently. The options noted above would restrict 'legitimate' rebidding that has a positive effect on market outcomes. For example these options would not permit rebidding by peak generators into lower price bands when market conditions indicate that there is likely to be a period of relatively sustained high prices. The introduction of some structural options could also require the introduction of a separate balancing market or increased and more extensive use of ancillary services.

There may also be issues associated with the enforceability of some structural options. For example, determining whether a technical reason was 'bona fide' and not manufactured in response to some other commercial incentive is likely to be very difficult due to the significant information asymmetry.

Regulatory or information disclosure options

Regulatory or information disclosure options increase the regulatory requirements around rebidding and are targeted at altering a trader's behaviour. For example a participant that rebids in a particular manner could be required to submit a quarterly report to the AER which explains the reasons for each rebid. This information would need to be more thorough than the 'brief, verifiable and specific reason' that must currently be submitted to AEMO for each rebid.

This intent of these types of options is to provide additional regulatory discipline on rebidding behaviour. It is hoped that additional requirements will alter a trader's behaviour so that they carefully

consider the purpose of any rebid and whether it is likely to breach the requirements in the National Electricity Rules.

The drawback of these approaches is that it is questionable whether they would provide sufficient incentive for significant change to current behaviour without amendment to the current rebidding provisions. It is likely that participants would just “explain away” their rebidding by reference to financial considerations. To the extent that these options apply to all rebidding, it may also provide a regulatory burden on market participants that is disproportionate to the benefits that may be obtained.

Conclusion on other options

In conclusion, however, in the absence of an outcomes based option (which would require substantial changes to the Laws and regulation), we consider, that on balance the SA Minister’s rule change proposal represents the preferable option.

- (b) Are there any approaches used in electricity markets in jurisdictions overseas that could provide insight into the development of options to address issues raised in the rule change request?**

This is answered in 6 (a).

6 Appendix B: Response to consultation paper Box 5.1: Rebidding in the Alberta market

Box 5.1 of the consultation paper presents the example of rebidding in the Alberta wholesale electricity market. The box refers to the *Offer behaviour enforcement guidelines for Alberta's wholesale electricity market*, and points to the Market Surveillance Administrator's (MSA) conclusion that conduct inconsistent with short-term efficiency can be acceptable so long as there is a corresponding benefit to long-term efficiency from the forces of competition.

The MSA statement appears consistent with the Commission's views expressed in its decision on Market Power in the NEM and, in principle, is supported by the AER.

The AER works closely with the MSA with both agencies being members of the Energy Intermarket Surveillance Group (EISG).² The AER and MSA have conducted staff exchanges to assist in understanding, common elements and differences between the two markets and our approaches to monitoring and enforcement.

While the consultation paper draws on the similarities between the two markets in emphasising the MSA's conclusion - that is focus should be on longer term market outcomes - the consultation paper fails to point out a number of differences which are noteworthy in the context of this rule change proposal.

The market price cap is an important difference between the two markets. The market price cap in the NEM is \$13 100/MWh, compared to the price cap of \$1000/MWh in the Alberta market. Therefore, the returns from spiking the price in the NEM for uncontracted capacity far outweigh those in the Alberta market, and hence the incentive to do so is greater. This means it is much more likely that participants in the NEM would engage in the type of conduct that may be regarded in a negative light in the Alberta market. We note that spiking the price may increase the incentive to enter into forward contracts. However, this still leaves time when generators are still sufficiently long so as to significantly benefit from exercising market power.

Another important difference between the two markets is whereas in the NEM participants are able to rebid within five minutes of dispatch, the Alberta market has a gate closure of two hours prior to dispatch. In the time interval between gate closure and dispatch, the market operator has significant visibility of expected supply and discretion to reschedule plant based purely on merit order.

The MSA's *Offer behaviour enforcement guidelines* describe its general approach in applying the Fair, Efficient and Open Competition Regulation (FEOC Regulation) to market participant offer behaviour in the Alberta market.

The FEOC regulation is an electricity-specific outcome based instrument that outlines acceptable and unacceptable conduct and behaviour in the Alberta Market in terms of competitive outcomes. The NEM has no such energy specific equivalent.

As an example, our analysis of the rebidding in Queensland throughout the summer of 2013-14 where CS Energy engaged in rebidding behaviour very close to dispatch and as a result precluded other participants from responding may have, if undertaken in Alberta, been inconsistent with the FEOC

² The EISG is the peak international group for coordination between energy market surveillance and enforcement bodies. The Energy Intermarket Surveillance Group (EISG) provides a forum for the private exchange of ideas about issues, techniques, procedures and other matters by those responsible for the surveillance of the competitiveness of wholesale electricity markets.

regulation. The following examines CS Energy's behaviour in the context of the Alberta market's regulatory framework.

Section 2 of its Guidelines provides an overview of the analytical framework applied by the MSA in assessing market participant offer behaviour, focusing on the importance of economic efficiency and relevant learnings from competition law.

Section 2.2.1 in the competition law section of the Guidelines talks about unilateral effects. We consider it likely that CS Energy's behaviour may have caught the MSA's attention in respect of what it terms "extension". Extension refers to conduct that prevents or impedes competitive response. Section 2.2.1.1 of the Guideline describes the type of conduct that would be classified as extension. This includes *Enhancing the effect of a unilateral offer strategy by engaging in transactions where the primary purpose is to reduce the response from competitors or customers*. The AER considers this characterises CS Energy's behaviour of rebidding late in the trading interval.

Section 3 of the Guidelines contains an overview of relevant provisions from the Alberta *Electric Utilities Act* (EUA) and the Fair, Efficient and Open Competition Regulation (FEOC Regulation). The FEOC Regulation is discussed in Section 3.2. Section 3.2.1.1 of the Guidelines discusses behaviour seen as "Restricting or preventing competition, a competitive response or market entry" (subsection 2(h) of the FEOC). The language here is similar to the principle of 'extension', and, for the reasons given above, CS Energy's behaviour would most likely warrant further investigation under the FEOC.

Subsection 2(j) of the FEOC, explained in section 3.2.1.2 of the Guidelines is concerned with "manipulating market prices, including any price index, away from a competitive market outcome". The Guidelines describe the term "manipulating" as implying "...conduct intended to control or manage an outcome." The Guidelines explain that objective intent must be determined through showing that a reasonable business person, understanding the facts and market circumstances at the time, would conclude that the consequences of conduct would be to move prices away from a competitive market outcome. The FEOC does not distinguish between short and long term behaviour.. The rebidding behaviour would probably raise suspicions in Alberta in this regard.

Section 3.2.4 of the Guidelines (Market share offer control) describes Section 5 of the FEOC Regulation, which places a requirement on market participants to not exceed 30 per cent of offer control. CS Energy has 35 per cent of installed capacity in the Queensland region and therefore would probably not exist in its current form in Alberta.

Although it is valid to focus on long-term outcomes, the AER considers that the FEOC would probably address the short run behaviour, observed recently in the NEM.

7 Appendix C: Proposed amendment to the National Electricity Rules

[1] Clause 3.8.22 Rebidding

Amend clause 3.8.22(c) as follows:

- (2) to *AEMO*, at the same time as the *rebid* is made:
- (i) a brief, verifiable and specific **statement of the** reason~~(s)~~ for the *rebid*; and
 - (ii) the time at which the event(s) or other occurrence(s) adduced by the relevant Generator or Market Participant as the reason~~(s)~~ for the *rebid*, occurred; and

Note

This clause is classified as a civil penalty provision under the National Electricity (South Australia) Regulations. (See clause 6(1) and Schedule 1 of the National Electricity (South Australia) Regulations.)

- (3) to the *AER*, upon written request, in accordance with guidelines published by the *AER* from time to time under this clause 3.8.22 and in accordance with the *Rules consultation procedures*, such additional information to substantiate and verify the reason~~(s)~~ for a *rebid* as the *AER* may require from time to time.

Note

This clause is classified as a civil penalty provision under the National Electricity (South Australia) Regulations. (See clause 6(1) and Schedule 1 of the National Electricity (South Australia) Regulations.)

[2] Clause 3.8.22A Variation of offer, bid or rebid

Amend clause 3.8.22A(b) as follows:

- (b) ~~In~~ **For the purposes of** paragraph (a) a *dispatch offer*, *dispatch bid* or *rebid* is taken **not** to be made in good faith ~~if~~ **unless**, at the time of making such an offer, bid or *rebid*, a *Scheduled Generator*, *Semi-Scheduled Generator* or *Market Participant* has a genuine intention to honour that offer, bid or *rebid* if the material **conditions and** circumstances upon which the offer, bid or *rebid* ~~were~~ **was** based remain unchanged until the relevant *dispatch interval*.

[3] Clause 3.8.22A Variation of offer, bid or rebid

Amend clause 3.8.22A(c) as follows:

- (c) A *Scheduled Generator*, *Semi-Scheduled Generator* or *Market Participant* may be taken to have contravened paragraph (a) notwithstanding that, after all

the evidence has been considered, the knowledge, belief or intention of the relevant *Generator* or *Market Participant* is ascertainable only by inference from:

- (1) information provided by the relevant *Generator* or *Market Participant* pursuant to clause 3.8.22(d);
- (2) other *dispatch offers, bids, and rebids* made by the *Generator* or *Market Participant* or in relation to which the relevant *Generator* or *Market Participant* had substantial control or influence;
- (3) the other conduct of the relevant *Generator* or *Market Participant*;
- (4) the conduct, knowledge, belief or intention of any other person; ~~or~~
- (5) information published by AEMO to the relevant *Generator* or *Market Participant*; or
- (6) any other ~~the~~ relevant circumstances.

Note

This clause is a rebidding civil penalty provision for the purposes of the National Electricity Law. (See clause 6(2) of the National Electricity (South Australia) Regulations.)

[4] Clause 3.8.22A Variation of offer, bid or rebid

After clause 3.8.22A(c) insert:

- (d) At the request of the AER, a *Scheduled Generator, Semi-Scheduled Generator* or *Market Participant* must provide accurate and complete data and information to substantiate that the *dispatch offer, dispatch bid* or *rebid* complied with paragraph (a).
- (e) A *Scheduled Generator, Semi-Scheduled Generator* or *Market Participant* must not vary the *available capacity* allocated to a *price band* in a *generation dispatch offer* or *dispatch bid* for a *trading interval* or any *dispatch interval(s)* thereof after the relevant deadline in the *timetable* unless the *Scheduled Generator, Semi-Scheduled Generator* or *Market Participant* does so:
 - (1) in response to a significant and quantifiable change in:

(i) price, demand or other data *published* by AEMO in respect of the *trading interval* or *dispatch interval(s)*; or

(ii) other material circumstances; and

(2) as soon as practicable after the change comes to its attention.

Note

Where a *Generator* or *Market Participant* expects a change to occur following its own *rebid* but that change does not eventuate, that is not a change in material circumstances.

(f) A *Scheduled Generator*, *Semi-Scheduled Generator* or *Market Participant* may be taken to have contravened paragraph (e) notwithstanding that, after all the evidence has been considered, the knowledge, belief or intention of the relevant *Generator* or *Market Participant* is ascertainable only by inference from:

(1) information provided by the relevant *Generator* or *Market Participant* pursuant to clause 3.8.22A(d);

(2) other *dispatch offers*, *bids* and *rebids* made by the *Generator* or *Market Participant* or in relation to which the relevant *Generator* or *Market Participant* had substantial control or influence;

(3) the other conduct of the relevant *Generator* or *Market Participant*;

(4) the conduct, knowledge, belief or intention of any other person;

(5) information *published* by AEMO to the relevant *Generator* or *Market Participant*; or

(6) any other relevant circumstances.

Note

This clause is a rebidding civil penalty provision for the purposes of the National Electricity Law. (See clause 6(2) of the National Electricity (South Australia) Regulations.)