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Australian Energy Market Commission
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Lodged web: <http://www.aemc.gov.au/>

Bidding in good faith rule change – options paper

The Energy Supply Association of Australia (esaa) welcomes the opportunity to make a submission to the Australian Energy Market Commission (AEMC) *Bidding in good faith* rule change.

The esaa is the peak industry body for the stationary energy sector in Australia and represents the policy positions of the Chief Executives of 37 electricity and downstream natural gas businesses. These businesses own and operate some \$120 billion in assets, employ more than 59,000 people and contribute \$24.1 billion directly to the nation's Gross Domestic Product.

The wholesale market is currently facing a range of challenges, the most significant of which is the level of oversupply and transition to a lower emission future. Industry would not include the dispatch mechanism as warranting change and would in fact note it continues to operate effectively.

Volatility in the spot price is an inherent and necessary feature of a market with the characteristics of the National Electricity Market (NEM). Flexibility is essential for maintaining a reliable system given the range of factors that impact on the dynamics of both demand and supply of electricity. As noted in the Options paper “an efficient functioning market need not provide an efficient price outcome in each and every dispatch interval. The iterative process of price discovery involves a dynamic process of participants learning and reacting to their competitors' action.”

A generator is only able to rebid the price up when they have transient market power. We would note that the AEMC has previously stated “transient pricing power, manifesting itself through occasional spot price spikes, is an inherent feature of a workably competitive wholesale market, and is only a concern if it occurs frequently enough and to a significant enough magnitude to lead to average annual wholesale prices being above the long-run marginal cost (LRMC) of generation.” As prices in the NEM remain below any plausible estimate of LRMC, it would suggest the materiality of any problem with late rebidding is low.

The operation of dispatch will always be imperfect, due to technical limitations and market design choices to limit administrative costs. Given the materiality of the problem is low, there needs to be clear evidence that any change provides benefits

that outweigh the costs. We would note that the likelihood of a non-market entity being able to correctly identify where the trade-off between efficient price discovery and rebidding restriction lies better than market participants through their existing hedging arrangements is very low. The AEMC has previously been sanguine about its ability to discern between a high price level that reflects 'true' scarcity rents or a high price occurring as a result of opportunistic bidding behaviour at a particular moment in time.

With respect to conduct provisions, once it is accepted that change in expectation is a perfectly legitimate reason to change a bid, it is very difficult to draft a provision that would not capture this type of behaviour, while limiting behaviour that is deemed undesirable. While the esaa of the view that no problem has been identified with a material impact sufficient to warrant changing the rules, if the AEMC is minded to make a change, the esaa supports the proposal to amend the current good faith provisions to acknowledge a shift in expectations by removing the need to demonstrate "change in the material conditions and circumstances". We agree with the AEMC that a generator should be able to, and have a genuine intention, to honour any offer. But we would note that it will be difficult to prove 'bad faith' beyond a physical inability to meet a bid.

Our position is set out in more detail in **Additional Information**.

If you have any questions relating to this submission, please contact Fergus Pope on 03 9205 3107 or by email to fergus.pope@esaa.com.au.

Yours sincerely



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Additional Information

The initial rule change proposal and some of the analysis in the Options paper seems to take a very asymmetric view.

Information provision – Pre-dispatch is very important to the extent that it can actually measure what will happen the next day. That said the most efficient price is the one at the time of transaction. Under the current arrangements only scheduled generation is required to supply information as part of pre-dispatch. Non-scheduled generation and demand response (DR) do not provide any information to the market and can only be observed at the point of dispatch as reduced demand. If full information is truly important, a greater focus on other parties providing information into pre-dispatch would seem to be a higher priority.

Only focusing on when rebidding increases prices – The focus of the Australian Energy Regulator's (AER's) analysis submitted to the AEMC as part of the rule change process is only where rebidding leads to higher prices. Putting aside the point that such attempts to differentiate between "good" and "bad" high prices are essentially spurious, rebidding can also lead to reduced prices. The ROAM paper notes that in most regions late rebidding in response to pre-dispatch indications of high price pushes down prices.

The focus on specific technologies from a single perspective – the paper seems unduly concerned about the supposed impact of late rebidding on DR and some gas plant. Plant characteristics are part of investment choice. Each type of plant has strengths and weaknesses. The paper notes that under the current rules some plant cannot respond to late rebids. It is odd that this concern is only extended to some gas plant and DR. If concern about response times was to be technology neutral, the proposals to change gate closure should be based on the characteristics of the least responsive plant. The esaa does not support this approach. Also looking at how plant is 'advantaged/disadvantaged' under a single scenario provides an incomplete picture. The paper claims baseload is best place to take advantage of late rebidding because it is always on. But the other side of the coin is baseload takes negative prices at times, because it is always on.

The gate needs to close earlier so DR and demand have time to respond – supply already has to deal with variability in demand. Late changes in demand can result in price outcomes and fuel usage that may not have occurred if demand had stayed constant for a set period of time. But it is not practical to restrict variability in demand.

The suggestion in the paper that an earlier gate closure would allow DR time to respond after which supply would have no opportunity to respond, offends the notion of competitive neutrality. This approach would make it extremely challenging for a generator to manage their contract position. We would note this disadvantage is completely different to DR's alleged disadvantage, as this would be a regulatory restriction placed on one type of market participant, as opposed to a technology limitation, which is a function of investment decisions.

Conduct provisions

The esaa welcomes the AEMC view that a trader's expectation is a legitimate consideration when changing bids. Generators have complete information around their own costs etc., but incomplete information around their competitor's costs and strategies. Traders need to form views based on a range of information and their expectation of how their competitors are likely to respond, when determining their bids. The very fact that this will always be based on incomplete information means judgement is required. As such, generators will always need the opportunity to change bids on outcomes that were anticipated, but did not occur.

Gate closure

The simple fact that the 'gates' need to be closed at some point means the theoretical risk of late strategic bidding will always exist. There will always be a bid that is the last bid, regardless how far ahead of time the gates are closed. In some cases, the 'last bid' might be received by the Australian Energy Market Operator (AEMO) immediately prior to the cut-off time for any additional rebids. If the gates were closed earlier all that would be achieved is a reduction in efficiency, as all information would not be taken into account up until the time of the transaction. This point is acknowledge by both the AEMC and in the Yarrow paper.

While the last "strategic rebidder" may theoretically gain a level of transient market power, other market participants will respond over time, as each trading period does not happen in isolation. Each dispatch interval feeds into a relevant trading interval, hourly experience, day, month, years informing the behaviour of all market participants.

Late rebidding is needed to ensure efficient market operation, as participants respond to volatile demand and pricing signals. Rebidding enables 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.

It is understandable the market prices cannot be accurately predicted. If the accurate price was known in advance it would negate the need for a market. Participants contract with an expectation they cannot physically match every demand interval (DI) for a variety of reasons. We would note plant running profiles do not ignore the risk of high or low prices occurring when they are off and others have transient market power. This risk is calculated in the context of turn on and off strategies, fuel strategies and contracting strategies.

Late response times are a function of dynamic decisions and would not be changed based on a half a dozen rebids that can't be responded to. Turning on is not always an efficient response. Exposure to prices can be the most logical position to take where financial positons are maximised through gas sales, avoided start-up costs, use of hedge and insurances contracts and investment in retail positions

Regional issue

The ROAM paper concludes “there is little evidence since 2007 of a systematic tendency across the NEM of generators rebidding towards the end of a trading intervals and rebidding just prior to dispatch”. While Queensland and to a lesser extent South Australia have not followed the recent trend of decreasing late rebidding, this is not an indication of a problem in of itself with the rules. In fact, if there was a problem with the rules it should be observable in all regions.

The rules for the NEM need to be set with a national focus, as they apply to all regions. The incidence of late rebidding appears to be concentrated in the Queensland region, according to the analysis commissioned by the AEMC. As discussed in this submission, we do not support the view that this represents a problem that needs resolving. To the extent that the AEMC disagrees, it is important to draw the distinction between systematic issues with the rules and regional phenomena that may have other root causes. In the latter case, the most appropriate response is to correctly diagnose the drivers of the observed phenomena and draw these to the attention of the relevant policy makers. This would be consistent with the approach adopted by the AEMC in the *Negative offers from scheduled network service providers* rule change process.

Solution

The esaa is still of the view that no problem has been identified with a material impact sufficient to warrant changing the market design. The proposed changes to gate closure will adversely affect efficient price discovery, outweighing any possible gains. If the AEMC is minded to make a change, the most appropriate course of action is the amendment of the good faith provision. This would also be more consistent with the original rule change request, which was focused on conduct provisions, not the question of gate closure.