Mr Sebastien Henry
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235
Lodged electronically

12 February 2015

Dear Mr Henry

Re: Options Paper – Bidding in Good Faith Rule Change ERC0166

This is Qenergy Limited's (QEnergy's) response to the Australian Energy Market Commission's (the Commission) Options Paper (the Paper) relating to generator rebidding and bidding in good faith. QEnergy is grateful for the opportunity to respond to this paper.

QEnergy is an established national electricity retailer based in Brisbane with customers in Queensland, New South Wales, Victoria, South Australia and the Northern Territory, specialising in providing retail electricity to small businesses. Because QEnergy is heavily concentrated in Queensland, where generator rebidding late in the trading interval has driven unprecedented market volatility, we are particularly concerned with the outcome of this rule change request.

As an overarching comment, QEnergy agrees with the 2013 South Australian Minister for Mineral Resources and Energy that there is an issue around the structure of the good faith provisions which govern generator rebidding.

QEnergy has, through our own experience, found that where generators rebid shortly before the dispatch interval, and particularly at the end of the trading interval, participation in the relevant markets becomes harder, with reduced risk management options and a lack of transparency.

Therefore, QEnergy considers that a change to the current rules is in order. We support redesigning the statement of conduct, similar to the good faith bidding provisions, and support restrictions on rebidding close to dispatch. Our suggested method for implementing these changes is to adopt the New Zealand model, changing the good faith provisions to reflect the design of the New Zealand 'safe harbour' provisions, as well as implementing a gate close at two hours prior to the trading interval, with any changes to bids or offers after gate closure only allowable for a genuine physical reason regulated under the abovementioned conduct rules.

Our specific responses to the consultation structure requested in the Paper are as follows.

1. Rebidding in the National Energy Market (NEM)

1.1. Defining the problem or market failure that has been identified by the rule change request

QEnergy agrees with the Commission that the specific behaviour to be addressed is generators submitting late rebids where there is an intention to exploit the limited opportunity of other participants to respond. In particular, QEnergy will focus on the impacts of behaviour occurring since the Paper was released – in November and December 2014 – which significantly increased

the volatility in the Queensland region and demonstrate the harmful effects on the participants in the market.

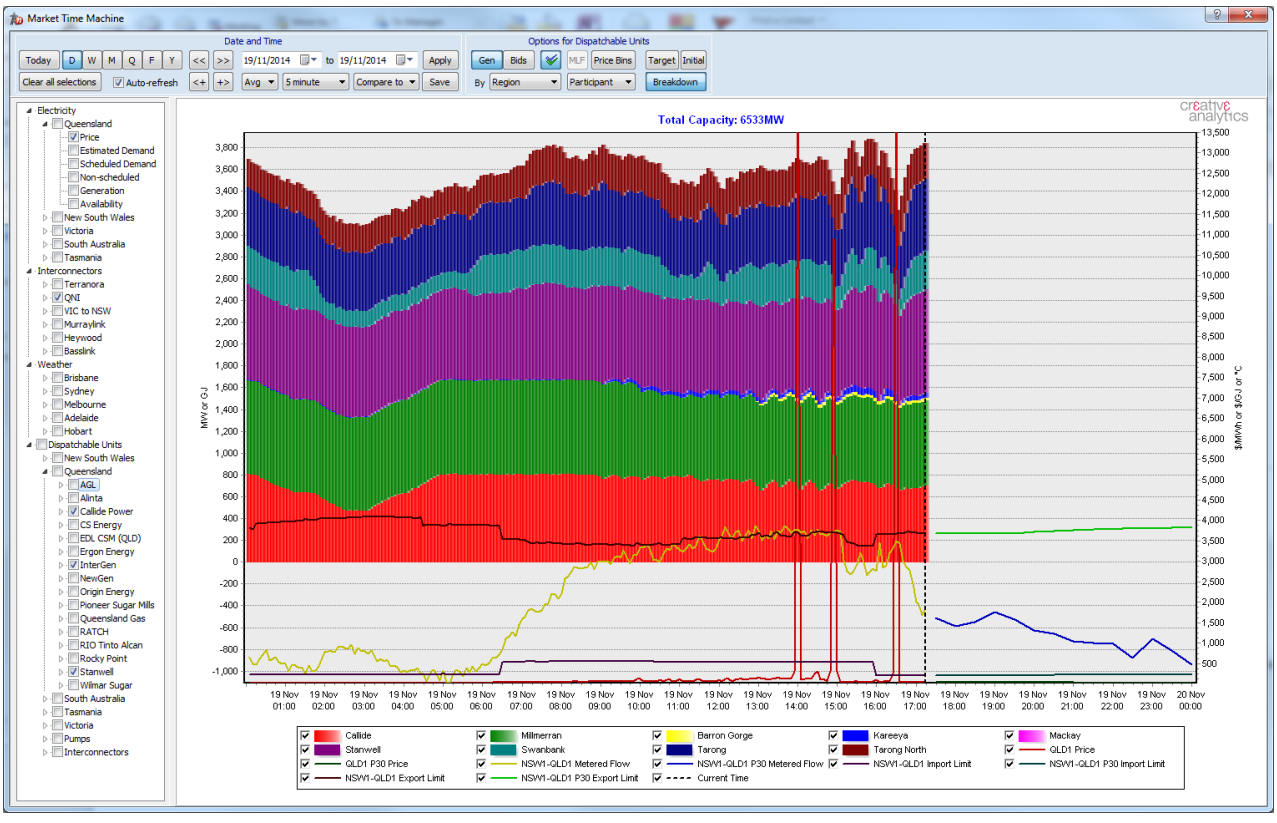
In this case, the generators involved were not vertically integrated.

1.2. Issues with rebidding

On 19 November 2014, there were three unexpected high price events, giving an average Peak price of $277/MWh. These events were similar to those experienced earlier on 3, 15 and 16 November 2014, where the Queensland-to-NSW interconnector (QNI) was constrained northwards in a small yet significant volume which limited supply from NSW.

Simultaneously, local Queensland (predominantly baseload) generation which was already in operation was withdrawn from low-priced bid bands close to the dispatch interval and was rebid in at very high prices. This is demonstrated in the chart below showing reduced dispatch of non-vertically integrated generators (particularly those owned by Stanwell Corporation and InterGen Australia) ahead of the second two events. Stanwell Ltd and InterGen Ltd dispatched sufficient generation resulting in the QNI remaining available for approximately 100MW of supply into Queensland, and then rebid 300MW of supply quickly (Figure 1 below).

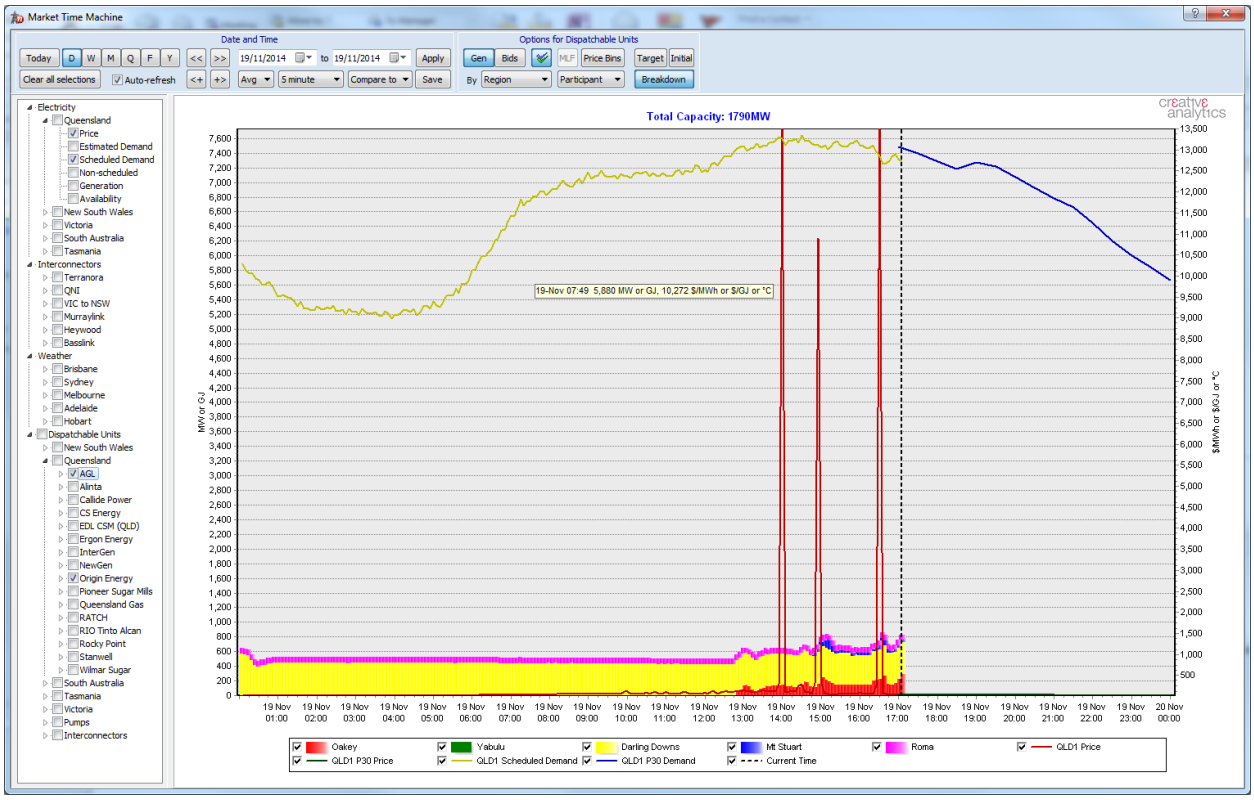
Figure 1. Dispatch of non-integrated generators on 19 November 2014 in Queensland



Origin Energy and AGL Energy, two vertically integrated generators, appear to have been unable to supply their capacity into the market sufficiently quickly to offset this impact despite having attempted to do so, as is shown in Figure 2 overleaf. Only a further 200MW was brought on line just after each high price event, in what appears to be a ramped up manner, suggesting that there may have been operational impediments to bringing on the full capacity sufficiently quickly.

This would support the concerns of the Commission that it is the late rebidding which determines outcomes in the market as other participants are unable to respond.

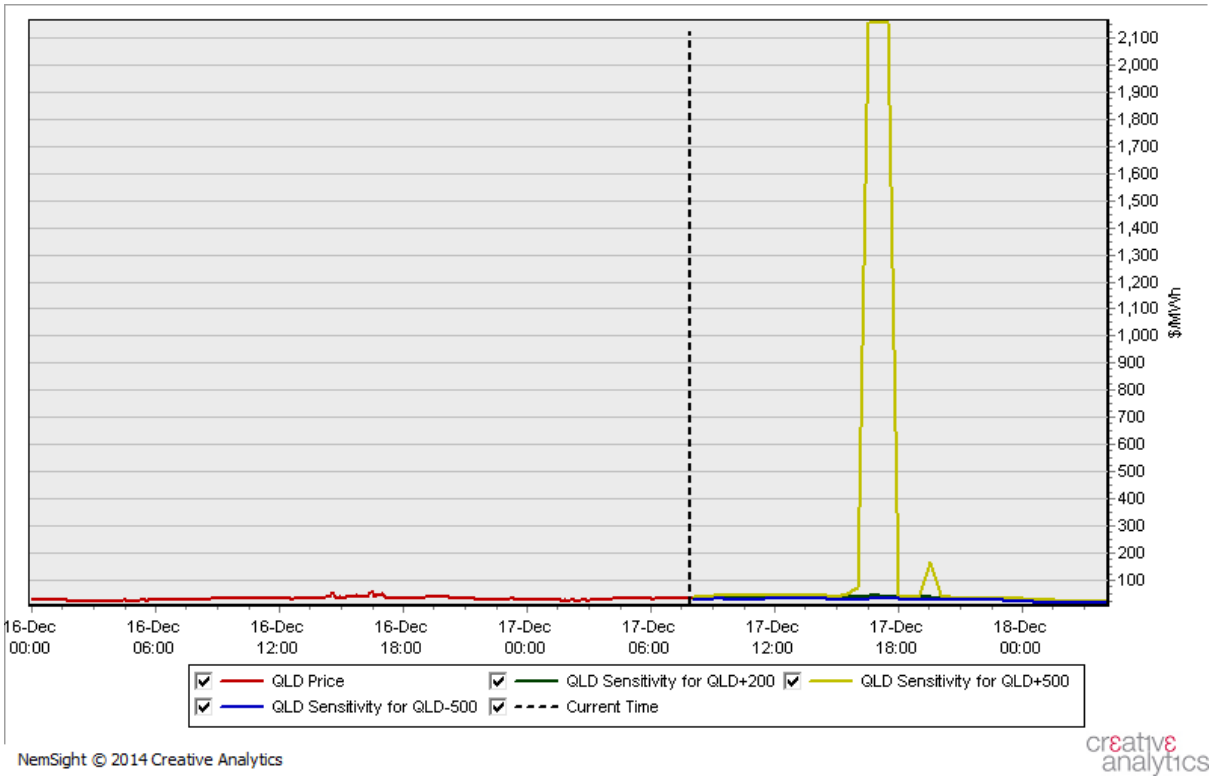
Figure 2. Dispatch of vertically-integrated generators on 19 November 2014 in Queensland



Subsequently, on Wednesday 17 December 2014, Queensland experienced its highest average daily price day since the creation of the National Electricity Market. Whilst hot weather was forecast for this day, the Australian Energy Market Operator (AEMO) pre-dispatch prices on 16 December for 17 December 2014 provided no indication that extremely high prices were expected. Unfortunately a snap-shot of the AEMO pre-dispatch prices at this time was not recorded.

On the morning of 17 December 2014, AEMO increased their forecast of market demand for 17 December 2014 by around 500MW to above 8,000MW. While demand was revised higher, market prices were still expected to be low unless 500MW was removed as shown in Figure 3 overleaf. Even with the withdrawal of 500MW supply, the prices were forecast to be consistent with those experienced through the majority of spikes in November, which had generally resulted in single half hour prices of around $2,300/MWh.

Figure 3. AEMO Queensland Pre-dispatch for 17 December released early 17 December 2014



On an hourly basis from 10am through to 1pm Queensland time on 17 December 2014 CS Energy Ltd shifted significant quantities (between 500 and 700MW) of generation from being available at $25/MWh to the market price cap of $13,500/MWh. Their bids at the open of 17 December are shown in Figure 4 below and their revised bids at the end of the day in Figure 5 overleaf. A significant shift into the light blue bidding region – at the market price cap – is clear.

Figure 4. CS Energy Ltd bids for Queensland 17 December 2014 at open of 17 December

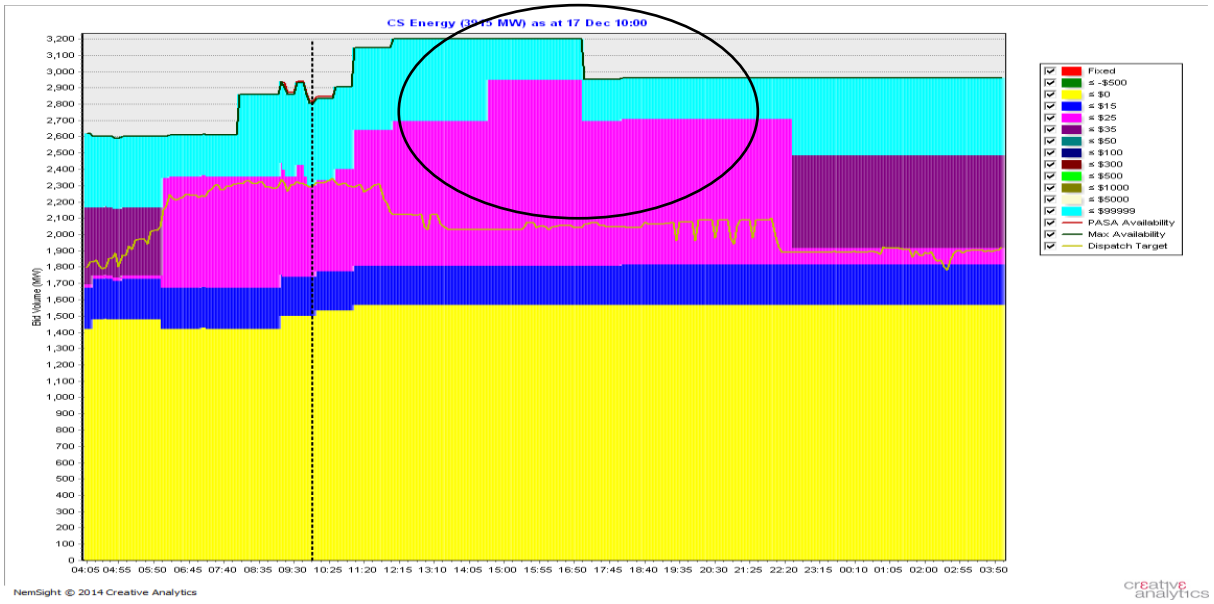
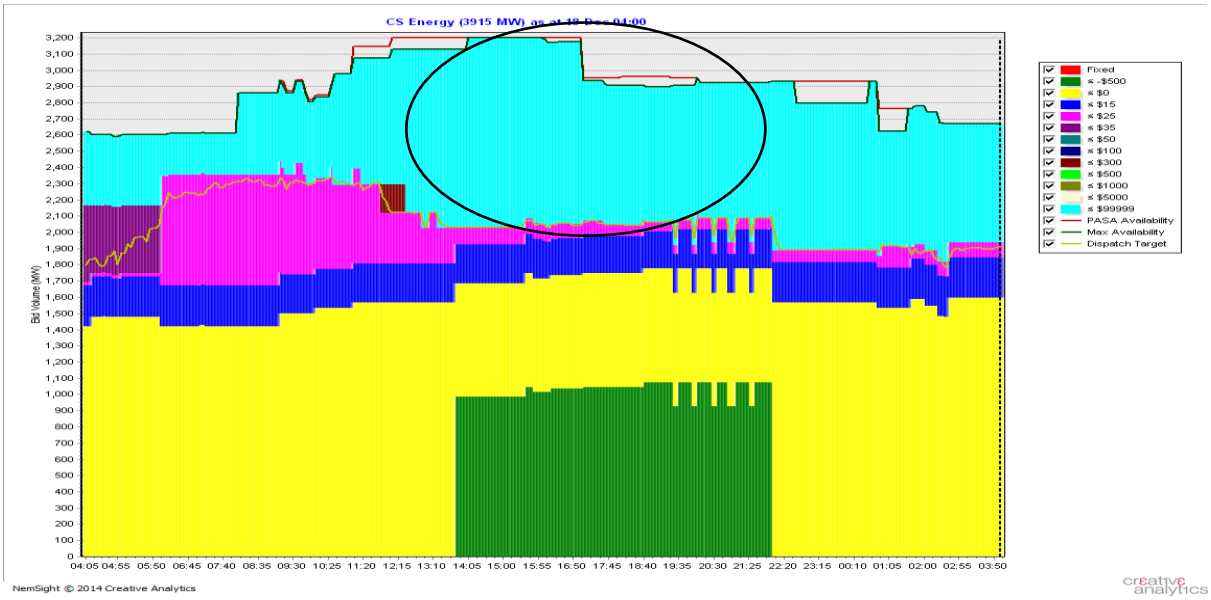


Figure 5. CS Energy Ltd bids for Queensland 17 December 2014 at close of 17 December



Changes in bids are not visible to the market on the same day so the first indication available to QEnergy of these changes came at 11am when AEMO revised their price outlook upwards to reflect sustained near market price cap outcomes in Queensland for much of the afternoon. Unfortunately a snap-shot of the AEMO pre-dispatch prices at this time was not recorded.

On 16 December 2014, QEnergy had reviewed additional cover options and on the basis of the pre-dispatch pricing, had determined that the only available cover – swap contract protection through the Australian Securities Exchange covering 20MW of balance of December in Queensland at a price of $101.42/MWh – was unjustifiable despite the warm weather forecast. Had the true, ultimate bids been known at that time, the decision would at that time have been different. Prices rose quickly after the release of AEMO's updated outlook.

A further impact on retailers is the rapid liquidity provision required in cases such as this event. On 18 December 2014, QEnergy received notification of the requirement for significant additional guarantees from AEMO, which puts pressure on both the capital availability and also the operational processes of retailer participants.

2. The impacts and materiality of generator bidding strategies

The impacts of late rebidding in cases such as those outlined previously are as follows:

- higher prices than would otherwise be the case owing to the inability of generators (such as those controlled by Origin Energy and AGL Energy) to dispatch in time to influence the outcome.
- consequences for retail participants' economic outcomes and for their capital positions (ie the need to provide significant prudential support in a very rapid period of time) as a result of those unnecessarily high prices.
- flowon higher prices for customers than would otherwise be the case.

Note that QEnergy does not believe that there should not be high-priced events in the market, since they are obviously a key part of the market design to support the delivery of generation investment as required. We do however consider that the late rebidding practices engaged in over the last few months in Queensland have meant that other generation was unable to be

dispatched in time, and consequently that prices were higher than they otherwise would have been had the market been functioning properly.

QEnergy is particularly concerned about the ongoing impact of this issue on Queensland prices. Like the Commission, QEnergy has observed that the incidences of late rebidding have been especially prevalent in Queensland since the consolidation of the original three government-owned generators into two corporations, with the attendant rebalancing of asset portfolios.

It is particularly worrying because these two generators – both owned by a single owner, the Queensland government – together control 81% of Queensland's baseload generation as well as 91% of the state's main ramping assets, the intermediate units. This effectively allows generators first to initiate late rebidding incidents – through withdrawing their baseload power supply from low priced bands at the last minutes of the trading interval – and then to control the market's response through not rebidding their intermediate capacity in response to those baseload withdrawals.

In the context of recent price events and outcomes based on Stanwell Ltd and CS Energy Ltd's late rebidding, QEnergy is gravely worried about the likely new Queensland Labor government's commitment to further consolidation of these two generators into a single entity.

Further, QEnergy would love to hedge further with the generators involved in these late rebidding incidents, to mitigate the impact of the subsequent price events on ourselves and our customers.

Unfortunately, the second-tier retailer's ability to protect itself from the impact of these exaggerated price spikes in Queensland is quite limited, a considerable barrier to interest in participation in the Queensland retail and wholesale markets. Sadly, Queensland's 'FRMP' model means that once won, Queensland customers are also extremely difficult to shed.

It is QEnergy's view that in markets in other industries, the bidding behaviour evidenced in the Queensland wholesale electricity market over the last two years, would be viewed in the context of misuse of market power, and the Rules need to be changed to address it. In 2013 in its review of potential generator market power the Commission found that, '*transient pricing power, manifesting itself through occasional 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 LRMC of generation*.[iv]'

QEnergy respectfully considers that this view is too narrow and that the specific and targeted incidences of late rebidding in Queensland – which are facilitated by asset ownership and market structure – do result in conditions where the misuse of market power is possible. This is clearly borne out in the outcomes for QEnergy (and ultimately consumers) from the market events throughout November and December 2014. QEnergy's concern is that it would be further exacerbated by the consolidation promised by the new Queensland Labor government.

2.1. Assessing the materiality of the problem

For QEnergy, the implications of this problem are material since 17 December 2014 was the most expensive day in Queensland's NEM history, and QEnergy was required to deliver one of the largest cash guarantees to AEMO in the company's history. In our view, some of that impact would have been avoided had the pre-dispatch pricing reflected the ultimate pricing, in that this may have allowed earlier acquisition of further hedge and even reallocation cover, reducing the immediacy of the impact on the company, and at the very least would have allowed more time for the arrangement of the security deposit.

The Paper quotes an AEMO estimate of the annual price impact of rebidding in 2013 at $0.22 / MWh in Queensland and $0.40 / MWh in South Australia. In QEnergy's view, these figures do not capture the significance of the impact of high prices on second-tier retailers. For example, if the

impact was experienced on a single day (and generally the impact is concentrated temporally), then the delta in prices would be $80.30 / MWh in Queensland (this is low by the standards of 2014) and $146.00 / MWh in South Australia. When this type of day is experienced, retailers are required to provide significant guarantees as well as funding the costs of the day, so the average annual price delta entirely misses the significant risk velocity of late rebidding events.

Not only is there an outright impact on the economic and capital position of participants in the market, but there is also an indirect impact through AEMO's prudential guarantee requirements. Because of the higher volatility in Queensland and South Australia as a result of the late rebidding practices, those volatility factors are the highest in the NEM. This has a multiplicative impact on the guarantees participant retailers are required to provide, with the average guarantees for Queensland and South Australia effectively twice the levels required for the average of the remainder of the NEM (Figure 6.). Again, this is a barrier to entry for competition.

Figure 6.

	NSW	QLD	SA	TAS	VIC
Average Price (P_R)	$37.96	$42.96	$49.05	$38.75	$35.25
Outstanding Limit Volatility Factor ($VFOSL_R$)	1.50	1.75	1.88	1.12	1.58
Prudential Margin Volatility Factor ($VFPM_R$)	1.74	3.00	4.18	1.09	2.76

2.2. Late rebidding and the effect on market outcomes

Based on the high prices during November and December – which appear to have been exacerbated by late rebidding and the inability of other vertically-integrated generators to respond – QEnergy considers that there is a material impact on market outcomes through this practice in Queensland. This further is a barrier to competition for retailers, which thus has a direct and indirect cost impact on customers.

2.3. The impact of late rebidding on the ability of participants to respond

As noted above, QEnergy believes that the late rebidding has had an impact on other generators in terms of not allowing time to respond. Further, it reduces risk management options for retailers, and makes attention to the subsequent collateral calls considerably more challenging.

3. Options to address the issues identified

3.1. Given the materiality, identifying potential solutions to the problem

QEnergy considers that a change to the current rules is in order. We would support redesigning a behavioural statement of conduct, similar to the good faith bidding provisions, and would also support restrictions on rebidding close to dispatch. Our suggested method for implementing these changes would be to adopt the New Zealand model, changing the good faith provisions to reflect the design of the New Zealand 'safe harbour' provisions, as well as implementing a gate close at two hours prior to the trading interval, with any changes to bids or offers after gate closure for a genuine physical reason regulated under the abovementioned conduct rules.

3.2. A behavioural statement of conduct

QEnergy does not believe that the current good faith provisions are operating effectively, and so would not support leaving them unchanged. Having reviewed the options presented by the Commission, our view is that a replication of the New Zealand 'safe harbour' provisions would

allow the regulatory bodies to address the specific behaviour that is being addressed, that is, where generators rebid shortly before the dispatch interval, and particularly at the end of the trading interval, leading to limitations on response by other participants.

The New Zealand option is appealing because it is already in operation in one of the most effective electricity markets in the world. As outlined by the Commission, under this structure, generators must observe a high standard of trading conduct, and compliance with three 'safe harbour' provisions would see automatic compliance:

- that a generator offers all of its available capacity
- that it revises its offers in a timely manner after receiving information triggering the revision,
- that it does not act to increase the price or benefit financially from an increase in the price at times when it is pivotal to the market.

In our view, it is the last element here that is the key (and indeed we note that in a number of markets throughout the world, rebidding to increase prices is prohibited). In the cases discussed, the non-vertically integrated generators involved would have failed at least the last of the three 'safe harbour' provisions. Whilst this does not guarantee that they would be found to have positively failed to 'observe a high standard of trading conduct', it would at least provide regulators with a basis for argument.

3.3. Restricting rebidding close to dispatch

QEnergy believes that the best outcome for the market would be for a gate close to occur 24 hours prior to the trading interval, since that would allow participants sufficient time to respond with further hedging, demand-side management or generation, and to arrange prudential guarantees should they be expected on the basis of a more realistic day-ahead pre-dispatch.

We do however also recognise that this would be a significant change to the NEM market design. Consequently, our view is that adoption of the second leg of the New Zealand market design – where changes to bids or offers after gate closure two hours prior to the trading interval must be for a genuine physical reason – would be an improvement on our current arrangements as that would allow both additional generation and demand-side management to respond.

We note that of all of the international comparators, New Zealand is the only one to have a price cap anywhere close to the level of that in the NEM. Consequently, it seems likely that the impact of all three elements together – the price cap, the 'safe harbour' provisions, and the gate closure rules – has been tested in real life.

QEnergy would be very happy to discuss any of these matters directly with the Commission, should that be of interest.

Yours sincerely

Kate Farrar
Managing Director

[i] AEMC, *Potential Generator Market Power in the NEM (November 2013) P 20.*