



Mr John Pierce
Chairman
Australian Energy Market Commission
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Submitted online: www.aemc.gov.au

12 February 2015

Project Number: ERC0166

Dear Mr Pierce,

Bidding in Good Faith – Options Paper

AGL thanks the Australian Energy Market Commission (**AEMC**) for the opportunity to respond to the *Options Paper: Bidding in good faith (Options Paper)* which discusses the outcomes of analysis undertaken to assess the nature and materiality of the issues under consideration and to test stakeholder views on a number of alternative potential options to address them.

AGL is one of Australia's leading integrated energy companies and largest ASX listed owner, operator and developer of renewable energy generation in the country. AGL has a diverse power generation portfolio including base, peaking and intermediate generation plants, spread across traditional thermal generation as well as renewable sources including hydro, wind, landfill gas, solar and biomass. AGL also sells and markets natural gas, electricity and energy related products and services to more than 3.8 million residential and small business customer accounts across New South Wales, Victoria, South Australia and Queensland, as well as to large commercial and industrial customers.

AGL firmly supports the objective of ensuring the market rules and regulatory framework promote efficient price outcomes in the National Electricity Market (**NEM**). This is fundamental to the market's ongoing sustainability, promoting a competitive price for the provision of electricity to consumers and providing accurate and timely investment signals to the market. The opportunity to rebid capacity in response to continually changing market and operational conditions facilitates this objective. The existing obligation to only bid or rebid in good faith – that is, to only bid or rebid with the intention of honouring the bid when made – is key to the process of efficient price discovery (of which pre-dispatch forecasts form part). This is well recognised by AGL and other market participants, who treat this obligation with utmost seriousness.

No evidence has been produced of ongoing or repeated issues of non-compliance with the good faith provisions by market participants. The ROAM quantitative analysis shows that, quite naturally, rebidding is often associated with changes in demand, network constraints, plant outages and high pre-dispatch price forecasts. It shows further that the effect of rebidding is very often to make a greater amount of capacity available to the market at lower priced bands and to mitigate price spikes forecast in pre-dispatch.

Late rebidding – which has emerged as the real issue of concern in the rule change proposal – similarly has not been shown to be particularly prolific or to show a clear pattern or tendency to move capacity to higher or lower price bands, with both of these movements occurring. The exception appears to be some recent activity in South Australia

and Queensland where rebidding has led to price spikes occurring at the end of a trading interval.

The fact that the 2013 South Australian activity subsided after a year indicates that it was likely driven by the particular circumstances prevailing in that region at that time rather than being symptomatic of an issue with the way the rules are drafted or participant compliance with them. Furthermore, AEMO's analysis shows late rebidding is likely to have contributed no more than a few cents per MWh to average pool prices in those regions in 2013.

Accordingly AGL is very concerned that such a wide ranging review of the market bidding rules and good faith provisions is being undertaken with respect to an issue whose materiality has not been established and the occurrence of which appears isolated in both time and location. Further, the review has seemingly been prompted by a single unsuccessful prosecution under the rules. This is surely an insufficient basis upon which to conclude there is an inherent deficiency with the current provisions, the regulator's ability to enforce them or participant compliance.

Extreme caution must be exercised before pursuing a change to the rules that may in fact negatively impact the realisation of efficient price outcomes in the NEM. As mentioned above, rebidding facilitates efficient price discovery and dispatch of generation capacity by allowing market participants to adjust their position in response to changing market and operational conditions, and in turn supports efficient investment over the longer term. Changes to the rebidding framework risk deterring the very activity that enhances market efficiency in the long term interests of consumers.

The AEMC appears to recognise that a rule change in the terms originally suggested by the proponent would have this effect. In our view, a number of the alternative options now being considered would also have this effect and our concerns with each are **discussed below**. The Options Paper notes that *'fundamental to the development of these options ... is a consideration of the behaviour that is sought to be prevented.'* An equally fundamental consideration must be the behaviour which is sought to be preserved. Without a clear market failure having been identified, AGL's firm view is that the status quo should be maintained and, if anything, the situation monitored for a further period.

Should you have any questions in relation to this submission, please contact Eleanor McCracken-Hewson, Wholesale Market Advisor, on (03) 8633 7252 or EHewson@agl.com.au.

Yours sincerely,



Duncan MacKinnon

Manager, Wholesale Markets Regulation



Option 1(a) – Status quo

Professor Yarrow's paper underlines the fundamental role that the ability to both bid and rebid has in achieving efficient price discovery and dispatch in energy only markets. Energy traders are continually working to discover the price point at which they can secure the dispatch of their plant ahead of their competitors and yet still recover their 'economic costs' of participating in the market. As Yarrow outlines, the assessment of where this point lies changes dynamically along with 'observable' market changes in supply, demand and price, as well as with the trader's own assessment of weather conditions and forecasts, of plant, operating and fuel supply conditions within its portfolio, of expected movements in its retail load (if integrated), of contract positions, and of how competitors might also be dynamically affected by and respond to all of these factors. The Judge's findings in the 2011 proceedings against Stanwell appear consistent with this understanding of efficient price discovery in energy only markets.

Given the range of factors that quite legitimately impact on generator bidding and rebidding decisions in an efficient price discovery process, then the strong implication is that a rule change in the terms originally proposed would have an adverse impact on market efficiency by dramatically limiting the factors permitted to be taken into account by market participants before making a rebid – that is, solely data published by AEMO. In addition, the proposed rule would introduce a great deal of compliance uncertainty (around the meaning of a 'significant and quantifiable change' and of a 'reasonable time' for lodging a rebid) and the volume of information and data expected to be kept and regularly produced by participants to justify each rebid would impose an unmanageable compliance burden.

All this, together with the highly significant proposal to also reverse the burden of proof, would combine to act as a severe dampener on a generator's or trader's preparedness to rebid capacity even when to do so would lead to more efficient market outcomes in the long term interests of consumers. Accordingly, we reiterate our view that to proceed with the original rule change proposal would be directly counter to a furtherance of the National Electricity Objective.

It is important to recognise that the rule change has been proposed on the back of a single unsuccessful prosecution under the rules. This appears to have provoked concern that market participants would seize on this outcome as an effective licence to disregard the obligation to only make bids or rebids in good faith. However the various reports and analyses commissioned by the AEMC to assist in the assessment of the rule change proposal do not evidence this. Bidding and rebidding in the NEM appears to be proceeding as you would expect it to in a workably competitive market. Fear that something might occur – rather than a clearly defined and evidenced market failure – is not a sound basis upon which to pursue a material change to the rules.

Generators and the traders they employ have developed a strong understanding of their obligations under the current market rules, including the obligation to only bid or rebid in good faith. AGL for one has an extensive internal compliance, training and assurance program. Further, participants are well aware that pre-dispatch schedules and price forecasts are non-firm and subject to change (including on account of the running decisions of non-scheduled generators and end user consumption decisions). Anticipating the impact of changes in market and operational conditions on dispatch and price outcomes is a skill learnt and improved upon through ongoing market participation. Any change to the rules would inevitably involve a period of adjustment while participants work to understand the full implications for their and the market's bidding practises and processes. The materiality of the issues identified in this review do not warrant imposing this kind of upheaval.

Although we acknowledge the concern with behaviour observed very recently in Queensland with price spikes occurring at the end of a trading interval, the AER's internal compliance system which monitors generators' compliance with bid and rebid information requirements has not revealed any overall divergence from the long term trend of compliant rebidding activity.¹ Nor did the ROAM analysis reveal any systematic tendency across the NEM of generators rebidding towards the end of trading intervals or just prior to dispatch. Until late strategic bidding emerges more distinctly as a frequently occurring

¹ Australian Energy Regulator, *Quarterly Compliance Report: National Electricity and Gas Laws*, July-September 2014, pp 15-16



practice, causing material detriment to efficient market operation, the status quo should be maintained and the existing rules around bidding in good faith remain unchanged.



Option 1(b) – Modification to existing good faith provisions

This option involves retaining the requirement that a generator must have the intention to honour a bid or rebid when made, but removing the reference to the material conditions and circumstances upon which the bid or rebid was based. A benefit of this option is that it might avoid distracting debates about what kind of 'conditions and circumstances' qualify for consideration when seeking to establish compliance under rule 3.8.22A(b), leaving the focus more directly on the underlying good faith requirement.

However, as the case for a change to the existing regime has not been made out – and given this modification seems unlikely to address the rule change proponent's individual concerns (whether founded or unfounded) – then we do not support this change being made at this time. There is a risk that it would only serve to introduce uncertainty amongst traders and generators, who have grown familiar with the existing market rules and the framing of the good faith obligations. This uncertainty might mute their confidence to respond to changing market and operational conditions and participate actively in the price discovery process, thereby negatively impacting the realisation of efficient market outcomes.

Option 1(c) – Behavioural statement of conduct

The Options Paper contemplates that a behavioural statement of conduct would specifically prohibit a market participant from making offers, bids or rebids which (a) are misrepresentative of its capability to achieve if dispatched, or (b) mislead other participants and exploit the limited opportunity of other participants to respond.

It is not clear how the first arm of this statement is an improvement on the existing, more broadly encompassing, requirement to only place bids and rebids in good faith. It also attracts potential problems when a generator believes at the time a bid or rebid is made that it could achieve dispatch, but an issue (such as fuel supply, plant or contractual event) subsequently arises which impacts this ability.

The arguments for including the second arm of this statement also seem rather circular. The Options Paper first acknowledges the difficulties in applying concepts of misleading conduct to bidding in the NEM – where participants are well aware of the ability to rebid capacity in response to changing market and operational conditions and that pre-dispatch schedules and forecast pricing are non-firm. However, the paper then goes on to say that, despite this, *'a bid or rebid may be misleading or deceptive if it was made in bad faith.'*

We therefore find ourselves back in the basic position of adjudicating conduct against a general obligation to only bid or rebid in good faith. The existing good faith obligations focus on the intent of the bidding generator. If the primary focus of a statement of conduct were also to be the intentions of the bidding generator, then it is unclear how this would be an advancement over the existing framework. This supports the view that this is an unwarranted and unhelpful change to the existing framework.

However, where the statement of conduct goes further and holds the bidder responsible for how other participants have interpreted their bids – however benign the bidder's intention – then this is a material departure from the current regime and runs the real risk of deterring otherwise efficient bidding behaviour, price discovery and dispatch in the NEM. It also seems to go directly against the earlier acknowledgement that reliance by a market participant on pre-dispatch schedules and forecasts would be difficult to justify.

We note that a particular skill valued in traders is their ability to formulate a bidding strategy which leverages their experience interpreting a vast array of continually updating information which has the potential to impact market outcomes. This includes anticipating the movements and likely responses of competitors to these same signals and changing conditions. Accordingly you would not expect that a deliberate strategy or pattern of behaviour over time that is designed to mislead other market participants would succeed for long until it is recognised by other participants who adjust their strategy accordingly.

While this observation does not condone such behaviour, it raises questions about the benefit of holding a bidder responsible for how their bids are interpreted by others compared with the potential chilling effect of such a framework on preparedness to rebid. We reiterate our view that, without evidence having been presented that the existing good

faith obligations are not being observed by market participants or that current bidding and rebidding behaviour is having a material negative impact on the realisation of efficient market outcomes, there is no case for change to the current framework.

We are also concerned about the intended status of a statement of conduct as a legal instrument. It would be important that, like the existing good faith provisions, any statement of conduct be set out in full in the Chapter 3 rules themselves so that a change to them must proceed via a formal rules consultation process. This ensures they are not susceptible to incremental change by a regulatory agency without a full assessment of market impacts.

Finally, the Options Paper acknowledges that all market participants operate under the general umbrella of competition law contained in the *Competition and Consumer Act* and that it would only lead to unnecessary regulatory duplication to replicate these provisions in the rules. It appears to AGL that the behavioural statement of conduct would indeed tend in this direction.

Option 2 – Gate closure

The current NEM design allows a close to real time adjustment by participants of the volume of capacity offered in a particular price band in response to ever changing market and operational conditions – whether it be a plant outage, network issue, demand spike, fuel supply issue etc. This dynamism and responsiveness is a strength of the current design, promoting the market's overall efficiency. Any form of gate closure will inevitably impact negatively on this responsiveness and efficiency. Price and capacity offers will be perpetually 'out-of-date' by the length of the prevailing gate closure and not reflective of underlying market conditions

Although a rebid very close to the relevant dispatch interval may not allow all other market participants to assess the rebid and implement a price or physical response, gate-closure only brings the last rebid forward in time. Someone will nevertheless always lodge the last rebid. The view presented in the Options Paper is that, while gate closure may not allow a further price response, it may allow NEMDE to dispatch a generator according to the bid schedule it has already lodged where that generator would otherwise be effectively ruled out by time constraints on ramp-up and synchronisation.

However all generators must constantly weigh-up the opportunities and risks associated with different running and bidding strategies. Every commercial operational decision (whether to run or remain off-line) involves a judgment call about fuel availability and costs versus prices that are expected to be seen in the market. Coal-fired generators with very long start-up and shut-down manage the risk that they will be online and facing low or negative market prices for a number of trading intervals as much as fast start generators manage the risk that they will be off-line during a short but high-priced interval. Residual risk is routinely managed through hedging and contracting strategies. To craft a gate closure regime specifically targeted to easing the ability of certain participants (e.g. idle gas turbines and demand response providers) to capture market value goes against established concepts of competitive and technological neutrality.

Although the CEG paper reveals that gate closure features in a number of overseas markets, it does not assess whether those markets are in turn characterised by greater levels of market efficiency than the NEM. Further, the comparability of those regimes is impacted by the underlying differences in market operation and design – for example, a number feature both day-ahead and balancing markets (France, Texas and PJM), others are characterised by a large proportion of direct volume contracting or government ownership (e.g. Singapore, France and ERCOT).

The Options Paper recognises the trade-off implicit in gate closure mechanisms between the promotion of efficient outcomes by allowing a flexible and timely market response to changing conditions and 'limiting the potentially disproportionate influence on price outcomes from rebids that occur close to dispatch'. Given that the AEMO analysis has not revealed a material market impact from the occasional late rebidding that does occur under current market design, then there is not currently a case for compromising the market's existing flexibility and efficiency.

Clearly defining the parameters of a gate-closure mechanism and the bids permitted during the closure period so as not to leave participants in an uncertain position as to how to proceed and comply in the new environment would also be a substantial task. A reform



of this magnitude would require a dedicated consultation process. However, it is not a reform that is called for at this time.

