



Bidding in good faith

Second draft determination released for consultation

The Australian Energy Market Commission has made a second draft rule to clarify appropriate generator bidding behaviour in the wholesale electricity market, providing clearer guidance about appropriate market conduct. This will make it easier for the Australian Energy Regulator to enforce rules to stop generators misleading the market through deliberately delaying rebids, while allowing rebids in legitimate pursuit of commercial interests.

The Commission's second draft determination

The second draft rule would amend the relevant provisions in the National Electricity Rules (NER) as follows:

- The current requirement that offers be made in good faith would be replaced by a prohibition against making false or misleading offers. False or misleading offers include those where a participant makes an initial offer, forms the intention to change that offer by rebidding, but deliberately delays making the rebid.
- Therefore, any variations to offers would need to be made as soon as practicable.
- A requirement to preserve a contemporaneous record of the circumstances surrounding late rebids would be introduced.

The Commission's second draft rule adopts elements of a rule change request submitted by the South Australian Minister for Mineral Resources and Energy, in particular, the requirement that any rebids made to vary an offer to supply the market would need to be made as soon as practicable.

Defining the issues raised in the rule change request

Participation in the National Electricity Market (NEM) requires that generators submit offers to the Australian Energy Market Operator (AEMO) specifying the minimum price they are willing to receive for the generation capacity offered. Following the submission of initial offers, generators may submit "rebids" to shift the capacity they are willing to offer to different prices to allow for changing market conditions.

Being exposed to sudden or uncertain price movements is an inherent aspect of participating in the spot market, reflecting innate risks in the power system where not everything is foreseeable. The ability to rebid provides generators with necessary flexibility to adjust their position to accommodate changes in market conditions and to respond to the offers or bids of other market participants. The resulting dynamic process of participants learning and reacting to the actions of their competitors is an important part of a well-functioning market.

Nevertheless, some late rebids may be deliberately late. Generators who systematically practise this form of late rebidding deliberately withhold information regarding their intentions from the market.

While the NEM has maintained the same broad market design since commencement, the widespread occurrence of deliberate late rebidding has been a recent phenomenon, occurring within the last two years, predominantly in Queensland and to some extent in South Australia.

The Commission has made a second draft rule to enhance the arrangements that govern the manner in which generators offer electricity to the wholesale market.

Deliberate late rebidding results in economic harm

The practice of systematic, deliberate late rebidding has the potential to decrease confidence in the forward information on which expectations are based, including AEMO's pre-dispatch forecast. A loss of confidence in the reliability of information can have significant consequences over time, limiting participation in the market. It may discourage industry from producing or even locating in regions that are subject to the behaviour.

Price volatility caused by deliberate late rebidding has inflated the value of financial hedge contracts. Market participants must always balance their exposure to the spot market against the amount of hedge contract cover they procure. Deliberate late rebidding linked to price volatility can alter this balance. In effect, some participants are paying a premium on contract market products in order to manage the price volatility that arises from this type of late rebidding. They are paying more either way – through spot prices or contracts.

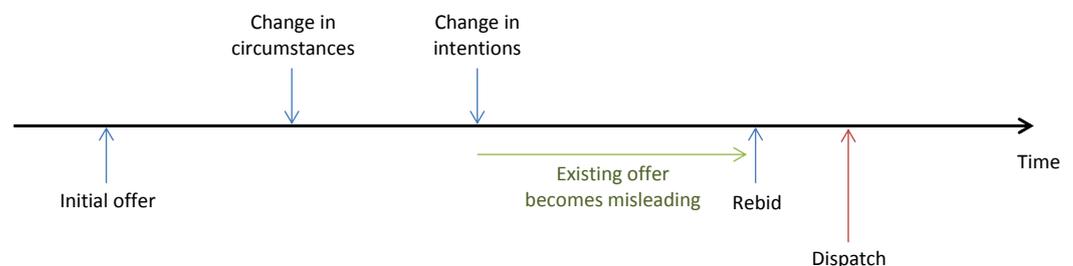
This may result in higher costs being passed through to consumers – both households and industry. Non-competitively priced hedge contracts also have the potential to affect retail competition and investments in other sectors of the economy.

The changes to the rules – the second draft rule

The Commission considers that the current rules are not setting reasonable boundaries on the ability of participants to influence price outcomes to the detriment of other participants, in a way that is not reflective of an efficient market.

The current rules require that, when an offer or rebid is made, it must be made in good faith. Therefore, providing an intention to rebid is formed after the submission of the initial offer, deliberately delaying making such a rebid until close to dispatch, in order to limit the opportunity for potential responses from other participants, is not clearly counter to the existing rules. At the time it is submitted, a late rebid is made in good faith in that the generator has a genuine intention to honour it.

Consequently, the second draft rule deems generators' offers as a representation of their willingness to provide supply at the prices they specify. This means that any rebid made to vary an offer to supply the market would need to be made as soon as practicable after the generator has formed the intention to make the rebid. The purpose of this obligation is so that the original offer does not become misleading with respect to the generator's intentions.



Compared to the current requirement that offers be made in good faith, the requirement to not mislead would establish a more objective basis through which the AER, and subsequently a court, would be able to infer a generator's intent. This would assist with the interpretation of and practical application of the rules. The draft rule would also allow a court to consider patterns of conduct, for example, repeated late rebidding by a generator.

The second draft rule would not prevent generators rebidding on the basis of a change in their subjective expectations, provided this occurs as soon as practicable.

The second draft rule differs from the first draft rule in the following respects:

- what is represented to the market when a bid or offer is made has been defined;
- the conditions under which an offer will be deemed to be false, misleading or likely to mislead have been altered in order to increase the enforceability of the rule;
- the obligation to report all late rebids to the AER has been replaced by an obligation to preserve a contemporaneous record of information pertaining to late rebids; and
- it has been clarified that the importance of rebids being made in sufficient time to allow other participants to respond is something a court must have regard to when considering an enforcement action, rather than a requirement on participants when rebidding – similar to the market design principles.

Additional recording requirements

The first draft rule imposed new reporting requirements for rebids made close to dispatch. Some stakeholders have expressed concern that the proposed obligations would create an onerous compliance burden, inappropriately limiting rebids that enhance efficiency.

The Commission has consequently decided to make a second draft rule that it considers would reduce the deficiencies in the current market framework, while remaining proportionate to the materiality of the issues.

The second draft rule would introduce new information recording requirements for late rebids. For each rebid made during, or less than 15 minutes before the commencement of, the trading interval to which the rebid applies, a generator would need to preserve contemporaneous information on the material conditions and circumstances giving rise to the rebid

Importantly, there is no requirement for participants to routinely compile information pertaining to late rebids into a report for submission to the AER, a key driver of compliance costs under the first draft rule. Participants would be free to devise their own forms and methods for preserving the contemporaneous record, so long as the required information was available on request by the AER.

A measured approach to the problem

The problem of deliberate late rebidding has not manifested until recently or in all regions of the NEM, and the resulting price outcomes may also be a function of market structure in specific NEM regions.

As a result, the second draft rule represents a measured approach to late rebidding, taking into account the materiality of the problem of deliberate withholding information from the market. The Commission considers that any additional compliance costs would be outweighed by the benefits to the market and consumers that the new rule would offer, through having a properly formulated and more enforceable standard of conduct.

The Commission welcomes submissions by 29 October 2015.

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