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25 October 2001

Mr Michael Rawstron
General Manager/Electricity
Australian Competition and Consumer Commission
PO Box 1199
DICKSON ACT 2602

Dear Mr Rawstron

BIDDING AND REBIDDING IN THE NATIONAL ELECTRICITY MARKET

I refer to the National Electricity Code Administrator's (**NECA**) referral to the ACCC of a number of Code changes concerning bidding and rebidding in the National Electricity Market ("NEM").

Eraring makes the following submissions:

1. No substantive case for change has been made

NECA has failed to provide any substantive case for the Code changes based on any specific evidence about either circumstances prior to the Code changes or subsequent to the Code changes about the operation of the NEM or the behaviour of Market Participants.

In particular, NECA has not provided any supporting documentation or evidence that the proposed changes would provide any public benefit.

The document which was published on the NECA web site sets out some of the analysis of rebidding activities in the NEM[1] and shows a selection of some rebidding events in the market. It needs to be emphasised that average prices in the NEM in relation to spot market activity remain at relatively low levels. Over the ten months to September, the average pool price in NSW was $36.60/MWh. On this basis, we believe that the market is working efficiently and that the proposals which are in train with regard to enhancing the interconnection between the regional markets, in particular the SnoVic and SNI proposals will, when completed, further stabilise pool prices.

While we support the points outlined in the Code Change Panel Report relating to tackling short-term price spikes (page 4) and the proposed changes made in Clause 4.3.6 (b) with regard to system security should not be included in this proposed

[1] NECA Bidding and Rebidding Strategies and their Effect on Prices 24 May 2001

authorisation. A more well-thought through proposal needs to be developed in this case.

2. The potential for high pool prices could be addressed through the maintenance of VoLL at its current level

The Code changes, which are designed to remove the potential for occasional high prices in the energy market, conflicts with NECA's recent advice provided to members of the COAG Ministerial Council on Energy that the market cap should remain unaltered at $10,000/MWh from 1 April 2002.

In that advice, it was noted that the ACCC '...was concerned about the potential effects on generators' market power and the potential for a combination for of that power and an increase in the price cap to be used artificially to ratchet up prices".

It is the level of the market cap that is a fundamental source of concern for Eraring Energy. If the potential for high prices remained a major concern for NECA, then Eraring Energy would support the need for a revision of market cap to a level which represented lower commercial risks to all participants but which retained the current efficient arrangements with regard to bidding.

3. The proposals will certainly add substantial additional compliance monitoring costs across the market which will need to be passed through to customers.

The failure to provide a definition of good faith in the proposed Clause 3.8.22A (see discussion on this below) is likely to result in different interpretations by participants in the market including NEMMCO and NECA.

From both an energy trading perspective and a power station operational perspective it would be difficult to assess what circumstances would constitute good faith and those which might not.

This is particularly the case given that there is no universally accepted definition of good faith in the Australian courts. Each State jurisdiction may have a different interpretation as to what constitutes good faith. To impose this obligation on operational staff in the electricity industry is clearly not practicable. Nor is it desirable.

Furthermore, it is by no means certain that this would result in a higher or lower outcome in terms of market prices as participants may simply not seek to dispatch capacity at a time when that would have a positive impact on market prices.

The uncertainty with regard to bidding in the market by operational staff when plant was required to be brought out of service or reduced in total capacity for operational reasons is likely to result in inefficient market outcomes.

It would be difficult to determine the actual price impact by the proposals but increased uncertainty with regard to the good faith criteria would be evidenced in:

- Lower levels of contracting by participants;

- The introduction of more complicated Force Majeure arrangements; and

- Higher levels of contract premiums above expected spot outcomes to account for the market uncertainties introduced by these proposals.

It is a major concern that NECA have not in their issues paper identified and assessed the impact of these particular issues in their application. Such an assessment is required in order to assess whether they are likely to impact on the public benefits test.

While Eraring Energy cannot itself determine the potential impact on the market, it is clear that these could be substantial.

4. The proposed Code changes, particularly with reference to the guidelines provide NECA with unfettered authority to impose new restrictions on generator bidding behaviour without the opportunity for further review.

The proposal under Clause 3.8.22B which outlines that offers should not be made which are likely to have an effect of materially prejudicing the efficient, competitive and reliable operation of the market suffers from a number of weaknesses including:

- Its implementation is likely to be vague and highly discretionary with NECA likely to exceed their mandate with regard to market surveillance;

- It is inefficient in the same way as the good faith test is in terms of impacts on energy trading and participants; and

- The costs of operating in this environment will undoubtedly increase and will have flow-on effects in the underlying cost structures of participants.

5. Legal Issues Associate With the Proposals

There are a number of fundamental legal impediments in the proposal. Specific concerns of Eraring Energy relate to:

- The Good Faith Test

- Reversal of the Onus of Proof

- Conduct that materially prejudices efficient, competitive or reliable operation of the market

5.1 The Good Faith Test

Clause 3.8.22A(a) of the proposed Code changes provides that:

"Market Participants must make dispatch offers, network dispatch offers, dispatch bids and rebids in good faith."

Neither the Code or the proposed Code changes define the term "good faith". It is difficult to define the exact meaning of the term "good faith" under Australian law,

and consequently, it is equally difficult to determine how the obligation under clause 3.8.22A(a) is either satisfied or breached.

Although there is a multitude of possible definitions for the term "good faith", there is not one universally accepted definition in the Australian courts or different State Jurisdictions.

Some Courts (commenting upon contract law) have given up the attempt to define "good faith", and instead have listed examples of things which are **not** good faith (ie instances of bad faith).

Accordingly, the meaning of good faith is uncertain and the content of the obligation under clause 3.8.22A(a) may vary depending on the circumstances of each bid or rebid and the state of mind of the generator at the time a bid or rebid is made.

In general terms, what NECA is seeking to prevent is strategic bidding which does not represent the actual intentions and expectations of the generator with regard to what capacity will be committed at particular price levels in rebidding. (It is a trite conclusion but the strategy which is being targetted is bidding and rebidding behaviour which is designed to raise pool prices. It may very well be that the current rules would operate in such a manner as to limit a generator's ability to reduce prices through rebidding.)

5.2 Reversal of onus of proof

Clause 3.8.22A(b) of the proposed Code change provides that:

> *"In any proceedings for a breach of clause 3.8.22A(a), a Market Participant is deemed to have contravened clause 3.8.22A(a) unless the Market Participant satisfies the Tribunal that the dispatch offer, network dispatch offer, dispatch bid or rebid was made in good faith."*

This means that the onus of establishing that the generator's bid or rebid was made in good faith rests on the generator. This is a reversal of the usual onus of proof being on the party contending that a bid or rebid was not made in good faith.

The National Electricity Code is a legislative instrument which is enacted under the National Electricity Law passed by each State.

There is a long line of authority that delegated legislation cannot rebut a common law assumption of statutory interpretation unless there is clear authority in the empowering act for delegated legislation to override an assumption.[2] There is Australian authority directly on point where delegated legislation was found to be invalid because it reversed the onus of proof.[3] The draft amendments to the NEC attempt to reverse the onus of proof.

It would be dangerous for the ACCC to authorise this amendment where clearly it is susceptible to legal challenge on the grounds that it is ultra vires. The ACCC needs to take into account clause 8.1.1 of the Code which states,

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[2] Hill v Green [1999] NSWCA 477; Lubcke v Little [1970] VR 807; Waterhouse v Knox (1909) 10 NSW SR 155; Pearce & Argument, "Delegated Legislation in Australia" (1999) Second Edition p.214.

[3] see Willoughby Municipal Council v Homer (1926) 8 LGR3.

"If any provision in this Chapter 8 purports to impose responsibilities, functions or powers on the ACCC, then those responsibilities, functions or powers, as the case may be, are deemed to be imposed on the ACCC only to the extent that the ACCC has the power to undertake, fulfil or perform them".

5.3 Conduct that materially prejudices efficient, competitive or reliable operation of the market

Clause 3.8.22B(a) of the proposed Code changes provides that:

> *"A Market Participant must not... rebid, if such conduct has the purpose, or has or is likely to have the effect, of materially prejudicing the efficient, competitive or reliable operation of the market ..... unless the Market Participant has reasonable cause ...."*

The conduct referred to in the above clause is the bidding and rebidding of Market Participants.

This provision centres on the meaning and scope of 2 key terms: "materially prejudicing" and "reasonable cause".

Materially prejudicing

Broadly speaking, the obligation under clause 3.8.22B(a) prohibits bids and rebids that materially prejudice the operation of the market.

There is considerable doubt and uncertainty surrounding the interpretation of the term. For example, prima facie material prejudice to the operation of the market might occur if:

- a generator does not bid its nominated capacity due to mechanical breakdowns, forcing other less efficient generators' units to come on line at a higher cost; or

- a generator does not bid its nominated capacity due to its forecast, and subsequent commercial decision, that the capacity will be needed for later demand, forcing other less efficient generators' units to come on line at a higher cost.

It would appear that the difference between bidded capacity and nominated capacity in the examples above does not necessarily need to be large to materially prejudice the efficient, competitive or reliable operation of the market. In periods of peak demand, withholding even a small amount of capacity may be enough to "materially prejudice" the operation of the market.

Accordingly, what constitutes material prejudice is likely to require a close analysis of the bid or rebid and its impact on capacity shortfalls in the market, peak and off-peak demand conditions, electricity prices, and the reliability and security of supply. This may almost be impossible as the time frames leading up to a decision of this nature are incredibly tight and may not lend themselves to the analysis needed to ensure compliance with the suggested provisions.

Reasonable cause

As noted above, if the Market Participant has "reasonable cause" to engage in bidding or rebidding that materially prejudices the operation of the market, it is not in contravention of clause 3.8.22B(a).

There is no definition or standard set out in the proposed Code changes as to what constitutes "reasonable cause" in the context of clause 3.8.22B(a). Once again there is considerable uncertainty as to what would constitute reasonable cause. As a result, it may be the case that reasonable cause could be established if a generator held an honest belief based on reasonable grounds that it had cause to bid or rebid regardless of its effect on the efficient, competitive and reliable operation of the market. It is also possible, however, that the defence would not apply to circumstances in which a generator could have taken steps to prevent the occurrence of the contravention. If this interpretation is adopted, it could be argued that a generator which suffers mechanical breakdowns could have taken steps to prevent the breakdown, and therefore, not be in a position to avail itself of the defence of reasonable cause. It should also be noted that the burden of showing this defence would lie on the Market Participant charged with contravening clause 3.8.22B(a).

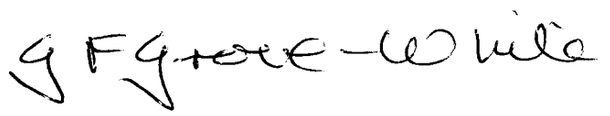
Conclusion

The wording of much of the amendments proposed by NECA is vague and highly subjective and is not supported by an cogent evidence. For example the obligation to bid and rebid in "good faith" is not defined and require a subjective investigation of the motives of a generator at the time of the bid or rebid. This could also be the case when attempting to define or determine whether the action of a generator is "materially prejudicing" the competitive operation of the market. The working and underlying concepts may be so vague and uncertain that a Court would not enforce these provisions.

Further NECA has not provided any cogent evidence of the benefits that may be established if the Code Changes are put in place. There is no evidence that there would be any benefit to the public, Market Participants or the operation of the NEM.

Another important issue is whether the process for the imposition of a penalty for breach of these provisions is reasonable, appropriate and consistent with general legislative policy and standards. There is a strong argument that the use of the NE Tribunal and the reverse onus of proof is unreasonable, inappropriate and inconsistent with general legislative policy and standards.

Yours sincerely



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MANAGING DIRECTOR

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