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

GWJ_00165 v:1 8.11.2001

8 November 2001

This submission is not confidential.

Dear Mr Rawstron,

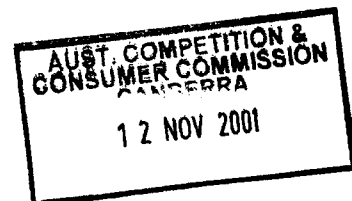
**BIDDING AND REBIDDING – PROPOSED CODE CHANGES
(ACCC AUTHORISATION NUMBERS A90797, A90798 AND A90799)**

We refer to the application to the Australian Competition and Consumer Commission (ACCC) under section 88 of the *Trade Practices Act 1974*, by the National Electricity Code Administrator (NECA) with respect to the proposed amendments to the National Electricity Code (Code) concerning '*Generators bidding and rebidding strategies and their effect on prices*'. In response to the invitation by the ACCC to comment on the potential anti-competitive detriment and public benefit associated with these proposed amendments, Delta Electricity (Delta) would like to make the following comments.

Delta has a number of significant concerns regarding the proposed Code amendments. These concerns include the lack of power by NECA to regulate pricing outcomes in the National Electricity Market (NEM), the failure by NECA to clearly establish the grounds that justify the change or quantify their potential impacts, the inappropriate attempt by NECA to 'engineer competition' into the NEM through these Code amendments, and the legal issues surrounding the introduction of the 'good faith' provision and the reversal of the onus of proof.

Delta considers that the proposed amendments will have materially adverse impacts on the National Electricity Market (NEM) and particularly on the pricing mechanism and the provision of long term investment signals. Delta is of the view that, on a proper analysis, the proposed changes will not satisfy the statutory 'public benefits' test for authorisation under section 90 of the *Trade Practices Act*. Accordingly, Delta considers that the ACCC should conclude that the proposed amendments should not be authorised.

Delta also supports the submission to the ACCC of the National Generator's Forum on this matter but would like to add some additional specific comments and emphasis regarding the above mentioned concerns.



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1. Lack of Power

It is considered that in pursuing these Code changes NECA has exceeded its powers conferred to that organisation under the *National Electricity Law* and the National Electricity Code. The NEM participating jurisdictions, in establishing the market governance arrangements, clearly intended that the ACCC and not NECA would be the economic regulator of the NEM and the ACCC would monitor *prices* where necessary under the *Trade Practices Act* (Code clause 1.2.1(c)). It is our view that this intrusion of NECA into what is considered to be an economic regulatory issue is, on a proper interpretation of the Code, *ultra vires* and therefore should not be authorised by the ACCC.

2. Lack of Clear Justification for the Proposed Amendments

In its issues paper on this matter¹ the NECA Code Change Panel has referred to a number of incidents of bidding and rebidding behaviour by generators which it concludes are variously a 'cause for concern', which 'do not represent genuine price signals', are 'disproportionate' and which may be characterised as 'market inefficiencies'. References have also been made by the Panel to the NECA Issues paper² together with NECA weekly and quarterly reports which canvassed individual instances of such behaviour by individual generators.

It is our view that the conclusions released by NECA concerning these supposed market problems was far from compelling and in any case totally ignored the role of the contract market in tempering the financial impact of the physical market outcomes on participants. Very little quantitative analysis appears to have been undertaken and any number of different conclusions can be drawn from the facts. The dangers of drawing hasty and ill researched conclusions about generators bidding behaviour in a competitive, real time, electricity market which is influenced by a large number of independent and interdependent factors has been detailed in overseas literature. In their research paper on the analysis of market power in the Californian market Harvey and Hogan have indicated that:³

"Identifying and diagnosing the exercise of market power is often difficult, particularly in tight supply and demand conditions. This task is further complicated in wholesale electricity markets by the need to take account of reliability policies and their impact on the bidding and operating decisions of even competitive firms. These complexities are exacerbated in California with its acknowledged flaws in market design and where the market rules combine to operate more like a pay-as-bid pricing system, which further reinforces the need to distinguish market inefficiency from the exercise of market power."

This brings us to our third issue for consideration which is the attempt by NECA to engineer competition into the NEM.

¹ NECA Code Change Panel, *Generators' bidding and rebidding strategies and their effect on prices, Volume 1 Report*, September, 2001.

² NECA Issues Paper dated 24 May 2001.

³ Harvey, S., and Hogan, W., *Issues in the Analysis of Market Power in California*, October 27, 2000 http://ksghome.harvard.edu/~.whogan.cbg.ksg/HHMktPwr_1027.pdf

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3. Engineered competition

In his speech to the 5th Annual South Australian Energy Market Briefing, Commissioner Rod Shrogen identified: ..

“that trying to engineer competition into a market that does not have a competitive structure is an uphill battle.”⁴

Delta is of the opinion that the NECA amendments are attempting to inappropriately redress, what is at least partially, a market structure issue exacerbated by inadequate electrical interconnections between NEM regions but principally to South Australia. If additional interconnections were developed and the national electricity grid strengthened, then competition in the NEM would be increased and concerns about an individual generator’s market behaviour would correspondingly diminish.

4. Variation of offer, bid and rebid

These proposed amendments under this Code rubric introduce two new concepts into the Code namely, the term of ‘good faith’ and the ‘reversal of the onus of proof’ in any proceedings for a breach of this provision before the National Electricity Tribunal. From a legal perspective these proposed amendments are problematic. We will canvass some of the legal problems associated with the use of each of these concepts in turn.

(a) Good Faith

The meaning of the term ‘good faith’ has not been defined in the proposed amendments and as such is open to a potentially wide range of interpretations. The Code Change Panel have stated that they do not consider that the term should be defined because:

“It is a commonly used term in legislation and contractual arrangements and therefore there is a significant body of precedent as to its meaning.”⁵

Delta is of the view that although there may be a wide body of precedent as to the meaning of this term, that precedent, if anything has indicated a diverse range of meanings.

Dictionary interpretations of ‘good faith’ variously include:

*“Propriety or honesty.
Banking and Finance: Good faith is based on the distinction between a person who is honestly blundering and careless, and a person who has suspicion that something is wrong but refrains from asking questions. The latter conduct amounts to bad faith or dishonesty.”⁶*

⁴ Shogren, R., *Stimulating fair competition in the SA energy market*, The 5th Annual South Australian Energy Market Briefing , Adelaide, 21 June 2001.

⁵ NECA Code Change Panel “*Generators’ bidding and rebidding strategies and their effect on prices Vol I Report* at p9.

⁶ *Butterworth’s Concise Legal Dictionary*, Second Edition, Sydney 1998 ed at 194

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*'honesty of intention; sincerity'*⁷.

*honesty of purpose or sincerity of declaration*⁸

Other meanings of 'good faith' include, to act without malice, to act fairly, to not act unconscionably, and to act with genuine intentions. This multiple of meanings has meant that the term can be quite ambiguous and subjective unless it is defined against some standard such as has occurred in various statute law.

Australian case law has considered the doctrine of good faith and it would appear that the general dictum that has developed is that the term does not lend itself to one common meaning.⁹ For example, in *Asia Pacific Resources Pty Ltd v Forestry Tasmania* (unreported, Supreme Court of Tasmania FC, 4 September 1997),¹⁰ the Full Court considered good faith. Wright J, in rejecting the implication of such a term at law, stated:

'The novel good faith concept, ... whilst capable of statement with beguiling simplicity can never be a pure question of law ... because even its most ardent proponents appear to recognise that good faith is incapable of abstract definition and can only be assessed as being present or absent if the relevant facts are known or are capable of being known - a little like proximity in the law of negligence'. [at 12]

In the paper by Justice Cole, *Law - All in good faith*¹¹. His Honour noted that there is "no shortage of possible definitions for the term good faith but there does not appear to be one universally accepted definition."¹²

Indeed, it is perhaps easier to define what is bad faith than what is good faith. For example, in *'Negotiating in Good Faith'* in Goldstein, S., (ed) *Equity and Contemporary Legal Developments*, Shalvey states: '

*"The concept of good faith cannot be independently defined or reduced to rigid rules; it acquires substance from the particular events that take place and to which it is applied. The difficulty of defining the good faith principles results also from the fact that it is not intended to dictate certain modes of behaviour. It is hard to say when good faith exists in a factual setting; it is much easier, and more common, to point to its absence."*¹³

⁷ *New Shorter Oxford English Dictionary*, 1993 ed. at 908:

⁸ *Macquarie Dictionary*, 2nd ed. at 754:

⁹ See Finn, P.D., *Commerce, the Common Law and Morality* (1989) 17 MULR 87

¹⁰ Cited in *Aiton v Transfield* [1999] NSWSC 996

¹¹ Cole, T., *Law - All in Good Faith* (1994) *BCL* 18 at 19

¹² Op cit at n10 para 109

¹³ Shalev, G., *Negotiating in Good Faith*, in Goldstein, S., (ed) *Equity and Contemporary Legal Developments*, The Hebrew University of Jerusalem, Jerusalem, 1992.

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The Code Change Panel in its report on this matter, whilst not defining 'good faith' has used expressions such as 'genuine intentions' and 'fair and honest dealing' but these expressions have not been included in the proposed Code amendments. In any case, it is considered that these concepts relate more to moral standards than to competitive conduct in a wholesale market of sophisticated participants.

This diversity of potential meanings will only lead to uncertainty for generators who must operate in the market and make real time decisions about bidding and rebidding plant. It is Delta's view that without the inclusion of some objective standard for the definition of 'good faith' in the context of Code clause 3.8.22A, the interpretation of that term will prove to be problematic and the uncertainty may in turn cause increased compliance costs, and the delay of submission of rebids, which may threaten reliability of the market during times of system stress.

(b) Reversing the Onus of Proof

The proposal by NECA to reverse the onus of proof for proceedings by the National Electricity Tribunal (Tribunal) for breach of the provision regarding 'good faith' is a significant change in the tenor of the Code. Under the proposed amendment, a generator who has been accused of a breach of this provision will be required to satisfy the Tribunal that their bid or rebid was genuinely made in good faith ie. the generator will have prove its innocence.

Although the Code Change Panel have drawn analogies to other areas of statute law where this reversal of the onus of proof has been effected, these have generally been restricted to areas of consumer protection. For example, the reference in the panel report to s51A(2) of the *Trade Practices Act*, which relates to Part V – Consumer Protection, concerns the making of future representations with respect to future matters where the corporation does not have reasonable grounds for making the representation. That section was introduced to address the evidentiary problem that was associated with the proof of a person's actual belief as to a future outcome.

The extension of the reversal of proof to matters of 'good faith' as required in the Code amendments is an entirely different matter. Whereas a defendant would be able to adduce factual evidence in defence of such an action under s51A(2), this would not be directly relevant to a proceeding for a Code breach because the proof of acting in 'good faith' will be subjective.

The presumption of innocence is one of the core foundations of the common law and it is Delta's view that the reversal of this burden of proof is unwarranted for this market. Additionally, it is Delta's view that the proposed reversal of the onus of proof is also contrary to the Code objective to provide a regime of "light handed regulation" of the market to achieve the market objectives (cl 1.4(b)(1)).

In summary, although Delta supports the objectives of a reputable market based on ethical considerations, it is Delta's view that the actual Code changes put forward by NECA regarding 'good faith' and the 'reversal of the onus of proof' will not further this objective and indeed represent an unjustified and "heavy handed" regulation of the market and specifically of generators in the NEM.

Delta opposes the Code amendments put forward to the ACCC for authorisation.

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Yours faithfully,

A handwritten signature in black ink, appearing to read "Jim Hennessy". The signature is written in a cursive, flowing style.

**JIM HENNESSY
CHIEF EXECUTIVE**