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

GWJ_00202 v:2
16.09.2002

16 September 2002

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 draft determination ("Draft Determination") of the Australian Competition and Consumer Commission ("ACCC") titled "*Changes to bidding and rebidding rules*" and dated 3 July 2002. That Draft Determination concerned the National Electricity Code Administrator's ("NECA's") application for authorisation of proposed amendments to the National Electricity Code (Code). A pre-determination conference was also held on 13th August 2002 in Melbourne to consider the Draft Determination.

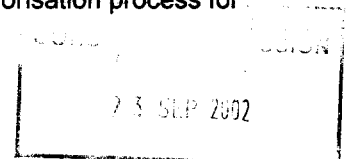
In response to the invitation by the ACCC to comment on the Draft Determination and issues that were raised at the conference Delta Electricity ("Delta") would like to make the following submission.

At the outset Delta would like it noted that it supports the submission of the National Generators Forum, which made a comprehensive submission to the ACCC during the consultation phase on this matter as well as a further submission relating specifically to the Draft Determination. Delta also relies on its earlier submission to the ACCC on the proposed amendments.

In the Draft Determination the ACCC proposes to authorise NECA's application subject to a number of conditions, the effects of which are to:

- Authorise the proposed Code amendments to provide that "Market Participant's must make dispatch offers, dispatch bids and rebids in "good faith";
- Delete the proposed Code amendments relating to the "reversal of the onus of proof" for contraventions of the good faith provisions; and
- Delete the proposed Code amendments relating to "conduct prejudicial to the market".

Delta has a number of concerns with both the Draft Determination and the authorisation process for this matter.



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Alleged “action” by the National Electricity Tribunal against Delta

The Draft Determination includes a reference to an action by NECA against Macquarie and Delta in regard to rebidding ‘must run’ capacity on 19-20 December 2001. The reference went on to indicate that the National Electricity Tribunal:

“found that both Macquarie and Delta had used the provisions inappropriately.”¹

We do not believe this to be a true record of this matter. Although the NECA has made comments in its report on the events of 19-20 December 2001 about Delta’s use of these provisions², this did not result in any action by the Tribunal against Delta and indeed there was no Tribunal finding about Delta on this matter.³

Delta is of the view that this inference as to a Tribunal finding against Delta on this matter should be corrected by the ACCC in the final determination.

Process Issues

Delta is concerned that both the ACCC and NECA as the relevant administrative decision-makers have not adhered to proper administrative processes in relation to consultations on this matter.

The ACCC has used its authorisation powers under s.88 of the *Trade Practices Act 1974* (“Act”) to introduce issues in the Draft Determination which might rightly be characterised as policy matters or market design issues. Neither of these functions has been assigned by the Commonwealth legislature to the ACCC under the Act or by the National Electricity Market (“NEM”) jurisdictions under the Code.

The ACCC has also used the Draft Determination to include ‘suggestions’ to NECA.⁴ The inclusion of such suggestions in an Authorisation Determination, especially suggestions which will have a material impact on the market design of the NEM, although arguably within the defined powers of

¹ ACCC Draft Determination, Amendments to the National Electricity Code: *Changes to Bidding and Rebidding Rules*, 3 July 2002, p62

² Report of NECA’s investigation of the events of 19 and 20 December 2001

³ National Electricity Tribunal Application No. 1 of 2002. In the matter of an Application for orders for breach of clause 3.8.22 of the Code by Macquarie Generation.

⁴ Namely that NECA:

- consider drafting a specific code change to prohibit ‘economic withholding’ where it is used to deliberately tighten supply and raise prices;
- specific restrictions on bidding of ramp rates,
- compulsory but confidential disclosure of contract volume and price information for all generators;
- delaying the release of aggregate bidding information from its current release one day after dispatch, to a period of several weeks or months; and
- contributing to the Market Review Forum as a mechanism for NEM participants to contribute to debate on topical issues.

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the ACCC relating to the authorisation process, is nevertheless arguably beyond the intent of that power.

The ACCC has the right to its own opinion about NEM design matters, and it has expressed that view in a number of venues including most recently to the COAG Energy Markets Review (“COAG Review”) but that right should not be confused with its statutory duty to process an application for authorisation. The suggestions that the ACCC has included in the Draft Determination have gone beyond what might be considered reasonable in this instance.

The inclusion of unsolicited suggestions by the ACCC in the Draft Determination has also introduced the potential risk of an apprehension of bias by the decision-maker in any subsequent authorisation process dealing with matters relating to those suggestions. For example, should the NECA develop Code changes that reflect the ACCC suggestions, there may be an apprehension that the ACCC may not bring an impartial mind to the consideration of those proposed amendments to the Code in any authorisation process. This would be an unwelcome development given the need for a very high level of confidence by market participants in the regulatory approval process.

Delta also has concerns regarding the way NECA has progressed these proposed Code amendments. At the predetermination conference NECA introduced further potential changes to the Code to give effect to some of those ‘suggestions’ made by the ACCC in the Draft Determination. These proposed Code changes were not canvassed with Market Participants prior to the predetermination conference and have not been formally progressed through the Code Change procedures specified in Chapter 8 of the Code.

The Managing Director of NECA has recently indicated that the NECA has now submitted additional proposals to the ACCC on this matter:

“We believe it is open to the Commission, consistent with your powers and obligations under the Trade Practices Act, to consider our revised proposals as part of the current determination process.”⁵

Delta is of the view that such an approach whereby additional or substantially revised changes are introduced at this late stage in an authorisation process without any prior consultation with market participants should not be agreed to by the ACCC. The ACCC should continue to make a final determination based on the original application for authorisation by NECA.

Should NECA wish to proceed with further amendments to the Code, then the proper procedures for Code changes and subsequent authorisation consultation by the ACCC should be followed.

Lack of Evidentiary Proof

One of the key principles of procedural fairness is that there is evidence to support the decision of the decision-maker. With regard to the exercise of the ACCC’s authorisation power under the *Trade Practices Act* it has been previously ruled in cases such as *Howard Smith Industries*⁶ that

⁵ Letter by the Managing Director of NECA, Mr Stephen Kelly, to the ACCC, NECA’s paper titled “*Bidding and Rebidding Some ideas for a way forward*” August 2002.

⁶ *Howard Smith Industries Pty Ltd (1977) 28 FLR 385*

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despite the difficulty in measuring public benefit in quantitative terms, general statements about possible or likely benefits will not be given weight unless supported by factual material.

Delta contends that the Draft Determination falls well short of this requirement in a number of areas. Firstly, the ACCC itself has indicated in the Draft Determination that:

“2 of the 3 consultants’ reports commissioned by the Commission have concluded that market power is not a systemic problem”⁷; and

“the Commission agrees with submissions that NECA has not adequately identified or quantified the problem in its application and is concerned that the uncertainty surrounding the interpretation of the code changes may give rise to significant compliance costs”⁸.

In its issues paper on this matter⁹ 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 paper¹⁰ 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 convincing and in any case ignored the role of the contract hedging market in tempering the impact of the physical market outcomes on participants.

Delta is of the view that without such substantiation or supporting factual information, the authorisation of the proposed Code changes by the ACCC would be a departure from the proper exercise of its discretionary powers in this area.

Market Power

Section 7 of the Draft Determination discusses the issue of market power in the NEM. The ACCC has indicated that through its discussion of economic theory and consultants’ reports written for the ACCC that it “*hopes to elicit the link between market power and the code changes.*”¹¹ Delta is of the view the ACCC has failed to produce substantive evidence of that link and prove that the proposed code changes are likely to have the effect of improved efficiency and therefore lead to public benefits. The argument for the delivery of public benefit through these amendments is even

⁷Op cit, n1, p68

⁸ Ibid., p55

⁹ NECA Code Change Panel, *Generators’ bidding and rebidding strategies and their effect on prices*, Volume 1 Report, September 2001.

¹⁰ NECA Issues Paper, 24 May 2001.

¹¹ Op cit., n1, p34

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more tenuous when the potential impact of such code amendments on perceived regulatory risk and future investment decisions are also appropriately taken into consideration.

Delta does not wish to repeat here the thorough analysis of the alleged exercise of market power by generators in the NEM which has already been analysed in detail by the Network Economics Consulting Group (“NECG”) whose report on this matter has been included in the NGF’s submission. However, Delta would like to emphasis three points that it considers are germane to this consideration, namely:

1. That despite the ACCC indicating that

“a complete understanding of market power in the NEM requires consideration of the spot and forward markets together”¹², and

..”In reality, the presence of a forward contract market means that focussing on the spot market in isolation tells only half the story”¹³

the ACCC and its consultants have failed to give proper consideration or to provide quantitative data on the effect of forward contracts on mitigating the financial impact of spot price volatility. Indeed the ACCC has admitted that they have not given much attention to the impact of contracts and that much of the information on contracts is, in any case, hearsay:

“Contracts have been largely left aside in this discussion”¹⁴; and

“much of the information used for assessing behaviour in the contract market is hearsay”¹⁵

Delta is of the view that this deficiency of hard evidence is scarcely a good foundation on which to draw substantive conclusions about market power or to the public benefits of the proposed amendments.

2. That spot price volatility is in fact an inherent feature of an energy-only market such as the NEM, and without such volatility new investment signals may well be muted, possibly contributing towards future supply shortages.
3. The Draft Determination suggests that market power exists in the NEM when one or more generators have the ability to influence or control the spot price. Delta is of the view that this suggestion ignores the conventional economic test for market power i.e. that it be enduring. The NEM market design ensures that the system marginal generator will be the spot price setter for the market yet this would hardly be considered as an exhibition of ‘market power’ in the conventional sense.

¹² Op cit., n1, p34

¹³ Ibid., p46

¹⁴ Ibid., p48

¹⁵ Ibid., p50

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Tacit Collusion and Gaming Behaviour

Section 7.3 of the Draft Determination canvasses the issue of gaming and tacit collusion in the NEM. In its exploration of this issue the ACCC has referred to overseas examples including the FCC spectrum auctions held in the United States and also theoretical posits on how it may operate in the NEM. Although the ACCC has not provided any evidence that such behaviour has occurred in the NEM, the inference which can be drawn is that such behaviour is the case.

Delta considers that this conjecture is both argumentative and unhelpful for any considered analysis of the NEM. Such conjecture is also prejudicial to the reputation of the NEM and the market generators, and also unhelpful in any proper consideration of the proposed Code amendments by NECA.

Good Faith

The ACCC has proposed to authorise amendments to the Code requiring that the bids of generators:

- be made in good faith; and
- represent a generator's honest intentions.¹⁶

In its Draft Determination the ACCC noted that many submissions were critical of the good faith requirement proposed by NECA.¹⁷

Most concern centred around the impreciseness of the term "good faith", the fact that it is not defined in the Code (nor it seems is it proposed to be defined in the near term, although the ACCC has "encouraged" NECA to "develop" a clear definition)¹⁸ and the real prospect that the uncertainty surrounding the term could lead to increased compliance costs and delay in submitting rebids.

The ACCC also noted that all of the submissions made by generators opposed the changes to the code¹⁹.

Among other matters, in its submission to the ACCC Delta raised concerns about the diverse range of meanings given to the term "good faith", and also noted that the concept of good faith related more to moral standards than to "competitive conduct in a wholesale market of sophisticated participants".²⁰

16 Op cit., n1, p56.

17 Ibid., p21.

18 Ibid., p57.

19 Ibid., p21.

20 Submission from Delta Electricity to ACCC dated 8 November p5.

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General Definitions of Good Faith

The meaning of the term "good faith" is not settled at common law but, as will be seen from the extracts below, there is something approaching a core meaning, which includes aspects such as:

lack of a positive act of malice or bad faith, while noting that:

"Negligence, stupidity, or blindness to what others might well be able to see are not equivalent to lack of good faith".²¹

honesty:

"A thing is to be deemed to be done in good faith, within the meaning of this act, when it is in fact done honestly, whether it is done negligently or not".²²

beyond honesty and lack of malice:

"...in a particular statutory context, a criterion of "good faith" may go beyond personal honesty and the absence of malice, and may require some other quality of the state of mind or knowledge of the relevant act...".²³

implied duty to cooperate:

*"There is an implied term in every contract requiring each party to do whatever is reasonably necessary to enable the other party to reap the benefit of the contract"*²⁴

"... in New South Wales a duty of good faith, both in performing obligations and exercising rights, may by implication be imposed upon parties as part of the contract".²⁵

The NSW Court of Appeal has also noted, however, that there is no duty to cooperate to bring about something which the contract does not require to happen²⁶ This is distinguished from a fiduciary obligation which typically would require a fiduciary (such as a company director, trustee or partner) to act in the interests of another person. The contractual duty of good faith requires only that the one party have regard to the interests of the other while primarily pursuing his or her own interest.

²¹ *Official Trustee in Bankruptcy v Mitchell* (1992) 16 FAM LR 87 at 95.

²² *Sale of Goods Act 1923 (NSW)*, section 5.

²³ *Mid-Density Developments Pty Ltd the Rockdale Municipal Council* (1993) 44 FCR 290 at 299-300.

²⁴ *Laws of Australia – Contract: General Principles/7.4 Terms/Chapter 2, Part B, Division 2, Paragraph 39.*

²⁵ *Alcatel Australia Ltd v Scarcella* (1998) 44 NSW LR 349 (CA) at 369

²⁶ *Australis Media Holdings Pty Ltd v Telstra Corporation Limited* (1998) 43 NSW LR 104 (CA) at 124.

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NECA's View of Good Faith

NECA has proposed the addition of clause 3.8.22A(a) to the code. The proposed clause states: "Market Participants must make dispatch offers, network dispatch offers, dispatch bids and rebids in good faith".

NECA has taken the view that good faith "represents no more or less than fair and honest dealing". NECA has also stated that initial bids and rebids should represent the genuine intentions of a generator at the time they are made.²⁷

In addressing the need (or rather the lack of need) to define the term "good faith", the NECA Code Change Panel observed:

"The Panel does not consider that good faith should be defined in the Code. It is a commonly used term in legislation and contractual arrangements and therefore there is a significant body of precedent as to its meaning. The Panel considers that any attempt to define good faith would significantly detract from the effectiveness and scope of the proposal".²⁸

NECA appears to regard the term "good faith" as a wholly subjective notion from which it seems to follow that the National Electricity Tribunal or a Court would need to undertake an inquiry into the state of mind of a generator or other market participant before it could be satisfied that in a particular case a bid or rebid was made in good faith.

The ACCC has indicated in the Draft Determination that it thinks it prudent to introduce a requirement that bids and rebids be made in good faith. A bid made in good faith will "therefore represent the true intentions of generators" and, in particular, "a generator's optimal price/capacity trade off based on the information it has to hand".²⁹

The ACCC regards the NEM as being particularly reliant on accurate information and that improved accuracy in bidding information will result in a net public benefit. The ACCC takes the view that there is sufficient legal precedent to make the term "good faith" workable. However, it has also recognised the need for certainty around the use of the term and would therefore "encourage" NECA to develop a clear definition as to what behaviour constitutes bidding in good faith.³⁰

NECA and the ACCC have different views as to the meaning of the term "good faith". In focusing on the accuracy of the information provided by a generator when bidding, the ACCC has indicated that the Tribunal or a Court would need to consider whether in fact the information provided was accurate when determining if a generator had acted in "good faith". This an objective test. In contrast, NECA has focused on the intentions of the relevant parties when making a bid.

²⁷ NECA Code Change Panel Report, volume 1 September 2001 p8.

²⁸ Op cit., n1, p9.

²⁹ Ibid., p56.

³⁰ Ibid., p57.

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We believe that the current lack of clarity surrounding the meaning of the term "good faith" as used in the code is a significant concern. While the term is common enough in legislation and in the law of contract, we do not believe that the definitions applicable in those circumstances will easily be adaptable to the electricity market. Most applications of the term "good faith" are concerned with contractual relationships or some other object of mutual interest, while in other contexts it is commonplace to require a public or other official to act in good faith in exercising a statutory or discretionary power.

NECA's views on the term's meaning are open to objection because among other things: they are too expansive; they depend on establishing the subjective intention of the parties; they are uncertain in application; they are likely to increase compliance costs; they may well affect the efficient operation of the market; and they are at odds with the ACCC's views. On the other hand, the ACCC's views would suggest a higher level of definition and certainty may be attainable.

As Delta argued in its previous submission to the ACCC on this proposed authorisation, that unless market participants have a very clear understanding of what "good faith" means in relation to bidding and rebidding in the NEM, the uncertainty will increase risks for generators and thereby the costs of compliance. This is further example of regulatory uncertainty that appears to be increasing in the NEM. Indeed, the issue of regulatory uncertainty and its impact on compliance costs and future investment decisions was a common theme in many of the submissions to the COAG Energy Markets Review as detracting from the benefits of the new electricity market arrangements.

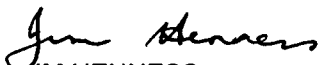
At the very least, Delta expects that the Determination will not be finalised until the term "good faith" is defined and, in particular, until NECA publishes and seeks comments on the guidelines the ACCC has suggested it develop. The mere encouragement of this course of action, while at the same time granting an authorisation for code changes, is not satisfactory to affected parties nor is it an acceptable way for the ACCC to discharge its function.

Conclusion

In conclusion, Delta considers that the proposed amendments and suggestions from the ACCC if implemented as Code changes by NECA 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 still 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.

However, should the ACCC decide to authorise the Code proposed amendment relating to "good faith" bidding and rebidding, as it has preliminary determined in the Draft Determination, then it should, as a minimum, include as a condition of authorisation that the NECA define "good faith" in this context and publish guidelines of how it will enforce this new provision. Additionally, such guidelines should be developed in consultation with market participants.

Yours faithfully,


JIM HENNESSY
CHIEF EXECUTIVE