



New South Wales

MINISTER FOR INFORMATION TECHNOLOGY,  
MINISTER FOR ENERGY, MINISTER FOR FORESTRY, AND  
MINISTER FOR WESTERN SYDNEY

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Professor Allan Fels AO  
Chairman  
Australian Competition and Consumer Commission  
PO Box 1199  
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30 SEP 2002

Dear Professor Fels

I refer to the Australian Consumer and Competition Commission's draft determination on amendments to the National Electricity Code relating to bidding and rebidding rules.

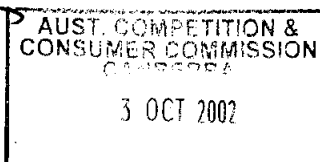
I consider it important to affirm the NSW Government's views on these proposed changes and enclose the attached submission on this matter.

This submission does not respond to the subsequent proposals emanating from NECA's "Bidding and Rebidding: some ideas for a way forward" issued on 2 September and posted on the NECA website. The NSW Government regards these proposals to be outside the ACCC authorisation process that is now well advanced. It therefore reserves the right to respond directly to the proposals contained in the NECA "ideas" document, should the ACCC incorporate these additional proposals into the current authorisation process.

I trust the Commission will afford the attached submission due consideration in reaching its final decision on this matter.

Yours sincerely

Kim Yeadon MP  
Minister for Energy





**MINISTRY OF ENERGY AND UTILITIES**  
NEW SOUTH WALES GOVERNMENT

**Submission to ACCC:  
Changes to Bidding and  
Rebidding Rules**

**September 2002**

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## 1 Introduction

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This submission responds to the Code changes that are currently under consideration by the Australian Competition and Consumer Commission (ACCC) as outlined in its draft determination.<sup>1</sup> This submission does not respond to the subsequent proposals emanating from NECA “Bidding and Rebidding: some ideas for a way forward” issued on 2 September and posted on the NECA website. The NSW Government regards these more recent proposals to be outside the ACCC authorisation process that is now well advanced. The NSW Minister for Energy will also be writing to the Chairman of NECA seeking clarification on some aspects of the NECA’s revised proposals, including clarification of whether the revised Code changes have been developed in accordance with the requirements of the Code.

The NSW Government nevertheless reserves the right to respond directly to the proposals contained in the NECA “ideas” document, should the ACCC incorporate these additional proposals into the current authorisation process.

The NSW Government remains firmly committed to an efficient, competitive and reliable national electricity market. The NSW Government continues to seek the development of arrangements in the National Electricity Market (NEM) that promote competitive outcomes and efficient investment. Robust, predictable and effective regulatory arrangements are prerequisites in achieving these objectives.

The NSW Government has continually highlighted the importance of stability in market arrangements and, more specifically in conjunction with all other NEM jurisdictions, reaffirmed this commitment at the 26 June 2001 NEM Ministers Forum.<sup>2</sup> The NSW Government is equally committed to a stable and predictable market and believes that proposed market developments or rule changes need to be shown to unambiguously advance the core objectives of an efficient, competitive and reliable market. In this context, the NSW Government places particular importance on the stability and predictability in market design and the quality of analysis that accompanies proposals for Code changes.

The NSW Government is concerned by the proposals and analysis contained in the ACCC document “Applications for Authorisation: Amendments to the National Electricity Code – Changes to bidding and rebidding rules”. The NSW Government has also previously expressed concerns regarding the proposed Code changes developed by NECA.<sup>3</sup>

In particular, NSW does not believe that the analysis of bidding and rebidding has been characterised by well-argued and careful analysis. The lack of well-founded analysis on this issue is of particular concern when the proposed Code changes present a material risk of imposing additional costs on the market, without any clear benefits.

This submission elaborates on these key points in the context of the rebidding debate and the further development of the national electricity market.

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<sup>1</sup> ACCC (2002) “Applications for Authorisation: Amendments to the National Electricity Code: Changes to bidding and rebidding rules”.

<sup>2</sup> NEMMF Communiqué, June 2001.

<sup>3</sup> NSW Treasury (2002) Submission to ACCC on NECA Code changes proposals.

## 2 NSW position on bidding and rebidding

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The NSW Government has reinforced its support for ensuring that electricity generators do not engage in inappropriate bidding behaviour on a number of occasions.<sup>4</sup>

In taking its stand on inappropriate rebidding, the NSW Government has also recognised that the majority of rebids are beneficial, leading to lower prices on average. The NSW Government generally regards the ability to adjust bids in the light of new information as a positive feature of the market. This flexibility, which is a desirable feature of the market, should not be prejudiced by ill-conceived rule changes.

In light of the importance of competitive market conduct for the realisation of the jurisdictions' NEM objectives, the NSW Government supports the role of the ACCC and NECA in ensuring strict compliance with both the *Trade Practices Act* and the Code. However, in respect of the Code changes proposed by NECA to curb bidding and rebidding, the NSW Government has expressed a concern regarding:

- the appropriateness of overlaying imprecise and ill-conceived additional rules on the NEM, which are not observed in other markets;
- the level of uncertainty inherent in the proposals; and
- the possibility that the proposed 'remedies' raise overall costs.<sup>5</sup>

### 2.1 Regulatory design

Judged by the standards of good regulatory design, the NSW Government considers that the process leading to the code changes proposed by NECA and the subsequent response by the ACCC fall far short of what is required.

The core principles of good regulatory practice include:

- a clear identification of the need for the proposed regulation or rule change, including a verifiable quantitative analysis of the cost and benefits of the proposed regulation;
- consideration of non-regulatory alternatives, and in particular the promotion of market-based responses;
- consideration of the potential unintended adverse effects of the proposed regulation; and
- ensuring that the outcomes of the proposed regulation are clear and predictable.

The NSW Government is particularly concerned that the rebidding debate has gathered significant momentum, as evidenced by NECA's development of a suite of code changes, well before it has been established that a material rebidding "problem"

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<sup>4</sup> Media Release, Friday 19 July 2002 "NSW commits to tough stance on rebidding".

<sup>5</sup> Speech notes – Opening address to the Public Interest Advocacy Centre Conference by the Minister for Energy (11 September 2002) and NSW Treasury (2002) Submission to ACCC on NECA Code changes proposals.

exists.<sup>6</sup> NECA itself has stated that it does “*not believe that there is a widespread or systematic abuse of either the bidding and rebidding or other provisions of the market rules. We have, however, identified some specific instances where the current incomplete state of development of the market and the lack, therefore of a fully competitive outcome have resulted in prices that have given cause for concern*”.<sup>7</sup>

It is clear that rebidding serves an important purpose in the NEM. It is not in the interests of customers, if ill-conceived code changes have the effect of raising prices overall, or depressing prices to the point where no new investments in generation capacity are made.

The wholesale electricity market has been the source of substantial competition-related benefits. Against this success, the NSW Government is wary of the desirability of introducing additional rules, such as those proposed by NECA, or the ‘suggestions’ proposed by the ACCC, that impose poorly defined obligations on generators over and above the existing obligations of the Code and the *Trade Practices Act*.

## 2.2 Regulatory risk

It is generally well understood that ambiguity in market rules and broad regulatory discretion are detrimental to the development of efficient markets. The consequences of greater regulatory risk are primarily two-fold:

- the costs of compliance increases with the level of uncertainty in the regulatory arrangements. These costs are borne directly by market participants, but indirectly by customers. The costs of compliance includes the direct reporting costs and the ‘opportunity’ costs associated with more conservative business strategies; and
- market entry will be deterred. Firms considering whether to invest will need to form expectations about market outcomes and the consequences of regulatory decision-making for their returns. The lack of regulatory certainty will particularly affect investors contemplating investment in long-lived assets, where predictions of future revenue streams are fundamental to support the business case for the investment.

Regulatory uncertainty cannot be eliminated because it is impossible to specify a complete set of rules in advance. However, the position of the NSW Government is that NECA and the ACCC should take particular care to avoid a course of action which substantially raises regulatory risks. In particular, the concern expressed by the NSW Government is that rules that are susceptible to misjudgement, by either the regulator or the regulatee, should be resisted.

## 2.3 Market-based solutions

In the event that a material market power problem is established, the NSW Government view is that realistic structural solutions are preferable to ambiguous

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<sup>6</sup> This gathering momentum is further evidenced by the new proposals developed by NECA “Bidding and Rebidding: some ideas for a way forward” posted on the NECA website on 2 September 2002.

<sup>7</sup> NECA “Performance of the National Electricity Market” Final Report June 2002 p6.

behavioural solutions. The reasons for this predisposition lie in the arbitrariness and uncertainties introduced into the market through behavioural rules, as outlined above.

The preferred policy response to improve the functioning of the market is to focus on steps to promote a market response, such as encouraging new entry and demand side participation, and to promote further interconnection through a robust regulatory regime. The NSW Government's preferred focus is therefore on the market fundamentals, including the promotion of new investment in the NEM.





### 3 The ACCC's Draft Determination

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#### 3.1 Market analysis

By their own analysis NECA has emphasised that the majority of bids either lower pool prices, or are benign, and furthermore that the numbers of bids and rebids that give cause for concern are by comparison very small. Notwithstanding these qualifications, NECA pressed ahead with code changes to rule out “unjustified” price spikes.

The ambiguity of the market analysis is also evident in the ACCC's analysis and conclusions. For example, the ACCC acknowledges that:

“some of the outcomes that have been attributed to market power in the past may not have been the result of the systemic exercise of market power but rather outcomes consistent with a cycle of market development inherent in all new markets”<sup>8</sup>

The NSW Government also notes that two of the three consultants' reports to the ACCC conclude that market power is not a systemic problem in the NEM. IES noted that an increase in prices had been followed by an increase in new investment. This cycle is exactly how the market should work. In particular, it appears that prices have performed the signalling role that they are supposed to provide.

Another consultant hired by the ACCC, MMA, found that although generators had incentives to withhold capacity to increase prices, such incentives were limited by competitive responses from intra- and inter-state generators, as well as the possibility of new generator entry. MMA also found that restricting or preventing rebidding would impose costs on the market.

The characteristics of the energy-only market are such that the NEM is prone to extremely volatile prices from time to time, and particularly in periods of high demand. Most market observers appear to understand that price volatility is not, in and of itself, a cause for concern. Nevertheless, the NSW Government is concerned that the importance of prices as a signal for new investment in the market will be lost in the focus on specific, transitory price events. Any analysis of the NEM must take into account the nature of the market, and the opportunities for new entry as a market response to high prices.

Similarly, the focus on specific prices for specific periods as illustrative of a general problem of rebidding overlooks the large number of bids and rebids that are unremarkable from a market power perspective. The ACCC itself notes that rebidding is crucial for the flexibility of the market and identifies the inherent difficulty in determining the difficulty in determining the difference between good and bad price spikes.<sup>9</sup>

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<sup>8</sup> ACCC (2002) “Applications for Authorisation: Changes to bidding and rebidding rules”, p54.

<sup>9</sup> ACCC (2002) “Applications for Authorisation: Changes to bidding and rebidding rules”, p55.

On the basis of the analysis of the ACCC's consultants, the conclusion of the NSW Government is that a case has not been made that there is a problem that would justify the suggestions put by NECA to the ACCC for Code changes. Equally, the NSW Government does not consider that the case has been made for the position adopted by the ACCC, and in particular the suggestions for NECA to further explore highly interventionist and intrusive forms of regulation.<sup>10</sup>

### 3.2 Good faith bidding requirement

Appropriately, in NSW Government's view, the ACCC's Draft Determination rejects most of NECA's latest Code change proposals. The Commission went on to:

- o require that the reversal of the onus of proof of whether a bid or rebid was made in good faith be deleted; and
- o remove the requirement on participants to not bid or rebid in such a way as to prejudice the efficient, competitive or reliable operation of the market.

However, the ACCC's Draft Determination retains the requirement that bids and rebids must be made in good faith.

NSW is particularly concerned that the proposed good faith rules may actually backfire, leading to higher overall prices. This point was explicitly acknowledged by the ACCC (p.72) where the Commission indicated that NECA's proposed guidelines are uncertain and may deter legitimate rebids. Notwithstanding this observation, the ACCC inexplicably accepted the introduction of a good faith rule and proposed that NECA should develop a clear definition about what constitutes bidding in good faith.

The NSW Government does not support the making of bids in 'bad faith'. However this does not extend to trying to *regulate* for 'good faith' bids where this is difficult. Although the concept of good faith is unobjectionable as a matter of principle, there are many interpretations of this concept in law, and these appear too vague to provide the basis for regulation in a real time market. The NSW Government is also generally opposed to the application of behavioural rules in the context of the wholesale electricity market. Such rules tend to be ambiguous, and by necessity involve substantial risks for market participants because of the substantial discretion left to regulators in attempting to enforce such rules. The end result of behavioural rules is that the level of uncertainty with respect to the application of regulation rises, compliance costs increase, as do the costs of enforcement, all of which are ultimately borne by consumers and taxpayers.

The NSW Government is opposed to rebidding behaviour that is inconsistent with an efficient and reliable market. However, rebidding generally leads to lower prices overall. Sifting the majority of "good" bids from the handful of "bad" bids creates a substantial problem for regulators, and if rules are developed which rely on this distinction, problems are also created for market participants in ensuring compliance against an uncertain standard.

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<sup>10</sup> ACCC (2002) "Applications for Authorisation: Changes to bidding and rebidding rules", p73.

In light of the ACCC's own reservations regarding the potential costs associated with such a rule, the NSW Government's view is that support for a good faith bidding *rule* is ill-conceived.

The NSW Government is generally opposed to the introduction of behavioural rules, such as the 'good faith' proposal. The reasons for this position include the difficulty in applying uncertain standards, including the costs of monitoring, and the potential to misidentify competitive behaviour as anticompetitive behaviour. Furthermore, focusing in behavioural remedies may divert attention from structural remedies that have the potential to address market power concerns (where demonstrated), with greater certainty and lower costs.

In this regard the NSW Government notes the discussion in the ACCC draft determination (p.47) dealing with information disclosure in the NEM. Under some circumstances, information disclosure can be a positive force for competition, allowing market participants to revise their bids or offers in response to new information. However, as noted by the ACCC, in some circumstances information disclosure can actually provide the basis for tacit collusion.

The NSW Government does not support amending the current information disclosure regime at this time. However if market power concerns are conclusively established, NSW supports the suggestion by the ACCC that changes to the information disclosure regime could be investigated as a possible remedy, in addition to other structural solutions. As outlined above, the benefit of such a black and white amendment to the market arrangements is that the proposal establishes an objective standard against which market participants can operate. Such proposals avoid the regulatory discretion associated with 'good faith' proposals or other interventions that rely on the subjective judgement of the regulator. It would nevertheless be important for these proposals to be carefully and critically evaluated in terms of their likely impact on market outcomes before such modifications to the market design are accepted.



## 4 Preferred approach - promotion of further development of the NEM

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The policy debate regarding bidding behaviour should be undertaken in a broader context rather than a narrow assessment of the efficacy or otherwise of prescriptive rules. NSW believes that a more constructive debate than that which has accompanied the rebidding discussions involves an assessment of the efficacy of steps to promote market entry, encourage interconnection and develop an effective demand side response. NSW emphasises that a focus on market development in these areas are more likely to be net beneficial than the further development of highly problematic and uncertain behavioural rules.

Poorly conceived intervention can lead to further rules and regulations that try to respond to their unintended side effects. The ACCC appears to acknowledge this point.<sup>11</sup>

As an alternative, NSW strongly supports the dissemination of high quality market information, the development of a robust interconnector regulatory framework, and lowering barriers to demand side response as key elements of the further development of a competitive national electricity market.

### 4.1 Promotion of new entry through information dissemination

The NSW Government places a significant importance on ensuring the electricity market responds to the rapid growth in electricity demand in the state.

In addition to the role of market prices in promoting new entry, it is possible to assist entry through the early identification of market opportunities. This logic lies behind the preparation of the Statement of System Opportunities (SoSO) produced in NSW by the Ministry of Energy and Utilities. The SoSO complements the Statement of Opportunities (SOO) produced by NEMMCO.

In light of the above, the NSW Government is deeply concerned that new entry may be deterred from entering the market by the constant proposals for new, often ill-conceived market rules.

### 4.2 Interconnection regulatory regime

One of the key elements in the development of the NEM lies in further interconnection. As NECA acknowledges in its recent Code review, "the recognition of the need for a strongly interconnected, and closely coordinated, national transmission network provided the initial impetus for the work that led to the creation of the market."<sup>12</sup>

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<sup>11</sup> ACCC (2002) "Applications for Authorisation: Changes to bidding and rebidding rules", p65.

<sup>12</sup> NECA (2002) "The performance of the national electricity market: Final Report", p3.

The NSW Government has been a consistent advocate for stronger links between regional markets. Such links allow the more efficient allocation of available generation capacity, access to cheaper fuel sources and, importantly, the promotion of competition benefits. The NSW Government is disappointed with the lack of development of the transmission system and particularly new interconnects. In this regard the Government will continue to strive towards addressing the shortcomings in the existing regulatory arrangements. In particular, there is an urgent need to improve the timeliness of the regulatory process surrounding interconnection development which includes resolving the inherent conflict between regulated and non-regulated regimes for interconnections. It is also imperative that changes be made to prevent gaming of the Code provisions that govern the development of regulated interconnects, to ensure regulated interconnects are not disadvantaged in the NEM.

On this point, the NSW Government is concerned that the ACCC, in its submission to the COAG Energy Market Review, appears to take a simplistic approach to interconnection.<sup>13</sup> In indicating a preference for a “market-based” approach to interconnection (p 68) on the basis that market driven approaches have the potential to drive the most efficient investment outcomes, the ACCC appears to overlook the possibility for the scope for market based investment to be suboptimal from a social perspective as acknowledged in other circles.

The apparent failure of the ACCC to acknowledge the institutional and market impediments to efficient investment in interconnection appears to play a part in the ACCC’s willingness to contemplate behavioural remedies as a substitute for structural solutions, including further interconnection. The ACCC appears to underplay the value associated in getting the regulatory and administrative arrangements for interconnection right, and instead appear to be attracted to the ‘quick fix’ approaches advocated by NECA.

Since the commencement of the NEM, NSW has actively supported interconnection projects which have demonstrated benefits to the market and to customers.

The recent problems of high prices and declining reliability in South Australia and Victoria would have been avoided by the earlier approval of regulated interconnection. NSW endorses the conclusions of consultants engaged by the NEM Ministers’ Forum to advise on interconnection issues where they concluded “that the current level of interconnection is not optimal now and could become less so moving forward” and “a retrospective public benefits test assessment would probably have found positive public benefits from some of the currently planned interconnects being developed earlier”.<sup>14</sup>

### 4.3 Demand side response

In terms of developing a viable demand side response, the NEM Ministers’ Forum is pursuing the development of strategies aimed at encouraging greater levels of demand side participation in the NEM.

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<sup>13</sup> ACCC (2002) “Reforming Australia’s Energy Markets: submission to the COAG Energy Review”.

<sup>14</sup> IES (2002), “Assessment of the adequacy and development of future interconnection: A report to the NEM Ministers’ Forum”, p.2.

Demand side participation involves market participants altering their demand in response to changes in the NEM, typically in response to price. Demand side participation can be realised through a variety of means such as contracts for interruptibility or the use of standby generators and have the effect of reducing demand at times of high prices. They provide a benefit to participants and other customers by lowering the pool price that might otherwise have applied.

The development of a strong and viable demand side response in the NEM is therefore an important consideration in providing increased competition for generation. A study undertaken for the NEM Ministers' Forum reports that while the level of reliable demand side response in the NEM is less than 1% of maximum load, there is potential for significant additional demand side participation should a number of key impediments be overcome.<sup>15</sup>

The NSW Government support for improving demand side participation does not extend to mandating expensive interval meters since for most customers the benefits of installing these meters would not outweigh the costs. The NSW Government's preferred approach is to ensure that the adoption of metering should be market-driven. Unlike regulated interconnects, the mandatory adoption of interval metering would not have a clear public benefit. That said, the NSW Government has worked to eliminate barriers to the use of a wide range of metering technologies to allow customers to choose the meter that best suits their needs.

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<sup>15</sup> Working Group on Demand Side Participation: Report to the NEMMF (June 2002), pp 14-15.

## 5 Conclusion

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The NEM has been highly successful in promoting efficiency in the electricity sector. The changes to industry structure and the development of a set of market arrangements have been fundamental to achieving the NEM jurisdictions' reform objectives of delivering improved energy services and improving efficiency in electricity pricing and investment. The Productivity Commission's report of May this year provides evidence of the value to the Australian economy of these reforms.

Notwithstanding the significant level of achievement of the NEM, some doubts have emerged in recent months as the NEM has moved from an environment characterised by excess capacity in generation, towards a more finely balanced system.

The symptoms of market power perceived by some may in fact simply reflect emerging capacity constraints. The NSW Government is therefore extremely wary about the virtue of introducing new rules which may deter legitimate bidding behaviour, undermine the incentives for investment, and in the long run, lead to problems of reliability and entrenched high prices.

The National Electricity Market must deliver on all governments' reform objectives, including competitive market outcomes adequate new investment. There is a risk that a focus on short term and transitory phenomena will override the longer-term costs attached to ill-conceived intervention.

The NSW Government supports the enforcement activities of NECA where market participants breach the Code as it stands. The NSW Government is not satisfied that NECA has established that its proposed Code changes have been satisfactorily assessed against the risks arising from their introduction. The NSW Government reinforces its position that any proposed Code changes including amendments to penalties must comply with a high standard of analysis.

In searching for remedies to perceived problems of market power the NSW Government is particularly concerned that the ACCC has underplayed the importance of interconnection, particularly when interconnection occupies such a central place in the NEM reforms. NSW also supports the development of an effective demand side response.

The NSW Government is aware that the ACCC has not endorsed the majority of the NECA Code change proposals. However, the ACCC support for the development and codification of a good faith rule, and the somewhat open-ended invitation for NECA to develop further proposals risks greater arbitrariness in market development regulatory processes. Although not the subject of this response, the NSW Government considers that NECA's recent proposal for further Code changes on bidding and rebidding can be traced directly to the ACCC "suggestions". The NSW Government is concerned that the ACCC's position on these suggestions, and in particular the indication that Code changes along the lines "would deliver beneficial outcomes", has not yet been demonstrated and cannot yet be justified.