2 November 2001

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Australian Competition and Consumer Commission
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By Email electricity.group@accc.gov.au

Bidding and Rebidding Code Changes

Dear Mr Rawstron,

Thank you for the opportunity to respond to the NECA code changes in respect of the bidding and rebidding provisions of the National Electricity Code, ("the Code"). At the strategic level, the NGF supports the need for the National Electricity Market (NEM) to remain a reputable market, trusted by both end consumers and participants, and to this end we remain open and available to work with both NECA and the Commission on the development of reasonable means of assurance of this integrity.

Regrettably, however, the NGF is of the view that regulatory intervention in the pricing process, such as that contemplated in the Code changes proposed, contains substantial risks of inefficiency and damage to the pricing signal. The energy price in the NEM is a fundamental driver to billions of dollars' worth of future investment and continued efficiency of the market under a market model. It is worthy of note that in excess of $1bn of peaking plant announced after the Summer of 2001 was a response to the price in that period, not the forecasts of its necessity for the prior 3 years in NEMMCo's Statement of Opportunities document.

In the NGF's view, there has been insufficient analysis of the standard required to justify the changes proposed. Indeed, the changes proposed are not supported by

- an adequate statement of the problem,
- any statement of the effects on the market efficiency or investment signals of the proposal,
- consideration of the economic basis of the proposals , or
- review of the legal basis or precedent for the changes in Code drafting.

In the NGF's view, the proposed Code changes do not constitute a reasonable means to ensure market integrity, because -

- the reversal of onus of proof is legally and conceptually flawed, (pages 2-4)
- while good faith is already a major legal element in the relationship between participants and NEMMCo and participants and their customers and suppliers, it has no place in the relationships with their competitors (pages 4-5)

- these two changes, taken together have significant adverse consequences (page 6)

Consequently, the NGF recommends that the proposed clauses 3.8.22 (a) and (b) should not be authorized.

In addition, since

- There has been no satisfactory demonstration of the competitive detriment associated with the events highlighted in NECA's Issues Paper,
- The Code prohibits rules of the type and for the reasons proposed (page 7)
- We believe NECA has no jurisdiction to remove price volatility (page 9)
- The proposed changes to the UK market rules are to cover a situation which does not exist in the NEM (a single region constraint) and these proposed changes have already been rejected by the UKCC (page 10)
- The NEM is far more dynamic and competitive market than is implied by the Code change proposal, and in particular the contract market removes the impact of many of the price spikes referred to in the Issues Paper, (pages 11-12)
- The events noted by NECA in the Issues Paper had no apparent effect on the contract market (page 13)
- The events noted had an undetectable effect on average pool prices, (page 14) and
- The separation of the guidelines from the Code means that the essence of the standards which the Commission is being asked to authorise is not available to the Commission for analysis, and subject to change without authorisation (page 9)

We further recommend that the bidding guidelines should not be authorized.

Yours Sincerely

Gerry Grove-White
Chairman
National Generators Forum

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1. Introduction

Representing as it does the major generation capacity participants in the NEM (including generation from several technologies) for whom the continued and reputable operation of the market is critical to its constituent's commercial success, the National Generators Forum (NGF) supports the need for the National Electricity Market (NEM) to remain a reputable market, trusted by both end consumers and participants. To this end the NGF has been, and remains, open and available to work with market regulators on the development of reasonable means of assurance of this integrity.

Regrettably, however, the NGF cannot accept that the current proposed Code changes are reasonable in the context of maintaining market integrity, because in its view, they

- represent a disproportionate regulatory response to a view of the market which is itself unsubstantiated, and more importantly
- have the potential to damage the underlying dynamics and efficiency of the market, and
- arguably threaten basic legal principles and offend the Code itself.

The National Generators Forum (NGF) questions the need for further regulation of the wholesale electricity market, given that it has demonstrated itself to be highly competitive, and to deliver timely new entry in response to scarcity pricing signals. The NGF is concerned that the driver for these proposals appears to be particular price outcomes, rather than any view of market failure, the very price outcomes which have delivered this new entry.

In the view of the NGF, the current regulatory environment based on market surveillance and the jurisdiction of the Trade Practices Act, has demonstrated itself to provide sufficient control over the competitive environment which exists in this market. While we remain open to reasonable measures that will enhance the reputation of this market, should a market failure be demonstrated, the following discussion details the reasons why the proposed Code changes do not achieve this reasonableness, and in fact are regressive.

2. Code Change Clauses

The NGF has a number of concerns with the drafting and wording of the clauses, and their combined effect.

The reversal of onus of Proof

The proposed introduction of the obligation to make a bid or rebid in "good faith" carries with it the proposal that a generator will be deemed to have contravened the good faith provision unless it satisfies the Tribunal that the rebid was made in good faith. Section 51A of the Trade Practices Act is quoted as a precedent for this change.

Section 51A of the *Trade Practices Act* does not relate to any notion of "good faith". It may be correct that section 51A involves a shift of the evidentiary burden of proof, but it does not do so in the context of a notion of "good faith". The context in which section 51A operates is manifestly different. In this regard, the following observations can be noted:

- Section 51A is an evidentiary rather than substantive provision. It is a subset of section 52. It deems a representation with respect to a future matter to be misleading for the purposes of section 52 of the *Trade Practices Act* if the corporation does not have reasonable grounds for making the representation.

- The question of whether the corporation has "reasonable grounds" involves objective concepts. For example, the fact that a person may believe in a particular state of affairs does not necessarily mean there are reasonable grounds for that belief. Further evidence of reasonable grounds can be established by evidence other than that of the persons who are alleged to have made the representations.

- Under section 52, it is the objective nature of the alleged contravener's conduct that is ultimately determinative of liability and not his or her state of mind.

- The shift in the evidentiary onus contained in section 51A(2) requires the corporation to adduce evidence to the contrary; that is, evidence that the corporation did have reasonable grounds for making the representation. Given the objective nature of the concept of "reasonable grounds", evidence of surrounding circumstances and events may be sufficient.

- Accordingly, although section 51A is evidentiary in nature and shifts the evidentiary onus of proof, it does so in the objective context of section 52; it does not require (or contemplate) the corporation bearing the onus of proof as to a subjective notion such as "good faith".

Several of the provisions in Part IV of the *Trade Practices Act* refer to the "purpose" of a provision or of conduct. It has been held that the language used in the *Trade Practices Act* indicates that it is necessary to the look at the *subjective* purpose of the individuals responsible for including the provision in the contract, arrangement or understanding or the subjective purpose of the use of market power (as the case may be). These provisions do not involve a shifting of the onus of proof so as to mean that a provision or a corporation will be deemed to have the proscribed purpose unless the alleged contravener can satisfy the court otherwise. At best, section 46(7) permits the existence of purpose to be ascertained by inference from the conduct of the corporation or of any other person or from other relevant circumstances.

As there is no shifting of the onus of proof in connection with ascertaining the subjective purpose of a provision or corporation under Part IV of the *Trade Practices Act*, it may be that there is no precedent for shifting the onus of proof in relation to the subjective question of whether a generator acts in "good faith".

The proposed Code amendment does not state that the evidentiary onus is satisfied if the generator adduces evidence to the contrary; it requires the generator to satisfy the Tribunal that the bid or rebid was made in good faith. This imposes a more stringent onus upon a generator than is contemplated by section 51A(2) of the *Trade Practices Act*.

In essence, section 51A requires the corporation to adduce evidence as to certain facts whereas the proposed amendment to the Code requires a generator to disprove the cause of action itself.

Therefore, while NECA proposes s51A as a precedent, it has not established the prudent need for the reversal, (ie argument that evidence would be problematic to find), it has gone beyond s51A (ie from evidentiary disclosure to deemed conduct) and has used the reversal in respect of a new concept – good faith in competition. *(See below).*

Firstly, it is arguable that the proposed Code changes' subversion of the fundamental common law rule of innocence until proven guilty in the proposed amendments is a denial of Natural Justice and against public policy.

Secondly, it is arguable that the assumption a party has not acted in good faith may place an unconscionably heavy burden on an accused. It is an inviolate principle of the common law that where a subjective test (such as the "good faith test" here) is applied to determine a matter before the court, it is up to the prosecution to make out what constitutes a party's state of mind at the relevant time *Woolmington v Director of Public Prosecutions* [1935] AC 462.

Accordingly, by reversing the presumption of innocence, the proposed Code changes are attempting to place a heavier burden on an accused than is imposed by Australian courts. It is arguable that the Code does not have the power to abrogate the common law or the plenary jurisdiction of the courts in this way.

The Code Change Panel states in the Report that:

> "In deciding whether or not to initiate a proceeding for a breach of this proposed clause NECA would first need to be satisfied that the market participant had prima facie acted in bad faith in submitting its bid or rebid."

In effect, if NECA must establish a "prima facie" case, NECA has that onus of proof. It is only if NECA can establish that "prima facie case", that a generator would need to bear an evidentiary onus in adducing evidence to rebut that "prima facie case".

However, this is not what the amendment to the Code provides for or contemplates. On the face of the proposed amendments to the Code, NECA or the Tribunal need only make the allegation that a bid or rebid was not made in "good faith"; it need not establish a "prima facie" case or even identify that there is a serious question.

The NGF is of the view that not only has NECA failed to identify a need for the reversal of onus its own explanatory note describes a different test and standard from that drafted in the code.

Good Faith

"Good faith" is a well-known concept. In general terms, it involves the requirement of honesty and the observance of reasonable commercial standards of fair dealing. However, it is applied in contexts very different from the operation of a series of functional markets, such as is comprised within the National Electricity Market.

It has been applied in contexts such as a mortgagee's exercise of a power of sale; the requirement for majority shareholders to act honestly and having regard to the interests of the company; the directors of an insolvent company disposing of assets to the detriment of creditors; the application of the principles of equity governing fiduciaries; undue influence and unconscionable conduct and the duty to refrain from making misrepresentations.

In the context of contracts, there is a developing body of law within Australia that a term of "good faith" may be implied into commercial contracts. In such a case, the concept of good faith involves the following three notions:

- An obligation on the parties to co-operate in achieving the contractual objects (loyalty to the promise itself).
- Compliance with honest standards of conduct.
- Compliance with standards of contract which are reasonable having regard to the interests of the parties.[1]

However, in each case "good faith" is applied to particular obligations or acts or a particular circumstance, event or arrangement in respect of, and for the benefit of, a identifiable person or class of persons with a common interest or common need for protection. It is not applied to dictate conduct in respect of a whole market, which has as its basic thrust, the development of workable competition at all functional levels. The disparate (yet legitimate) interests of participants in a market, together with the fact that they are intended to engage in rivalrous competitive behaviour across several functional and geographic dimensions, render the concept of "good faith" in such a context inappropriate and unworkable.

In *Queensland Wire Industries Pty Ltd v. Broken Hill Proprietary Co Ltd*[2], the High Court of Australia made the following observation:

> "But the object of s46 is to protect the interests of consumers, the operation of the section being predicated on the assumption that competition is a means to that end. Competition by its very nature is deliberate and ruthless. Competitors jockey for sales, the more effective competitors injuring the less effective by taking sales away. Competitors almost always try to 'injure' each other in this way. This competition has never been a tort … and these injuries are the inevitable consequence of the competition s46 is designed to foster."

[1] *Alcatel Australia Ltd v. Scarcella* (1998) 44 NSWLR 349 at 367.
[2] (1989) 167 CLR 177 at 191.

Given this endorsement of the High Court of "competition", it is difficult to see how "good faith" has a role to play in a dynamic and competitive market between market participants who have no connection with each other, save for the fact that they participate in the National Electricity Market.[3]

Good faith and "Onus of Proof" taken together

Firstly, it may be said that the behaviour sought to be regulated by the proposed Code changes is properly within the jurisdiction of the ACCC, and that NECA has no power to enforce the proposed amendment.

Secondly, if the ACCC were to approve the proposed amendments it could, in effect, constitute a delegation (or even an abdication) of the ACCC's powers to enforce Section 46 of the *Trade Practices Act* 1974 (Cth). It is arguable that the ACCC is not afforded the ability to delegate its functions under the *Trade Practices Act.*

Clauses 3.8.22A (a) and 3.8.22A (b) are arguably intertwined. The purpose of clause 3.8.22A (b) relies on clause 3.8.22 (a). For example, if clause 3.8.22A (b) were not approved by the ACCC, clause 3.8.22A (a) would be rendered pointless and vice versa. Accordingly, it is arguable that approval or rejection of one clause necessarily requires the approval or rejection of the other.

The Report does not explain how the two amendments will work together, other than to indicate that a generator, when determining bids or rebids must satisfy *both* requirements. This recommendation of cumulative tests, and the reversed onus of proof, also presents issues. For each bid or rebid a generator (but not a load managing retailer) must undertake (verifiable) analysis of the following

- Will the bid be made in good faith?
- Will evidence be available to support the bid or rebid being made in good faith?
- Will the rebid have the purpose of materially prejudicing the operation of the market ? (which will have to take into account past, present and future foreseeable or anticipated conditions and circumstances operating across the whole market)
- Is the likely effect (in the sense that there is a real chance or possibility) of the rebid that it will materially prejudice the operation of the market?

Each of these questions will need to be assessed in the context of

- Each bid and rebid (for the reason that the proposed Code changes refer to that specific act), not withstanding the fact that the number of bids and rebids is enormous, no bid or rebid can be assessed in isolation, and that the period that elapses between a bid or rebid and the circumstances requiring a subsequent rebid severely restricts the ability to asses (or asses meaningfully) each of the above questions

[3] This is not to reduce the standard of good faith that would be owed to NEMMCo is respect of system security issues.

- A set of tests with the ambiguities and causal and interpretive problems identified above.

The NGF is therefore of the view that since the Code change proposal has not demonstrated a need for either good faith concept in the presentation of a generators competitive positioning, or a reversal of onus in respect of any component of a bid, these two elements (proposed clause 3.8.22A) should be completely removed as a matter of course.

The NGF is also concerned at the introduction of either of these concepts as *specifically* used in this (3.8.22A) context.

3. The Code

Clause 1.5.4 of the Code provides that:

"NECA is bound to comply with and perform any duties and obligations imposed by the Code."

Clause 3.1.4. (b) of the Code provides that:

"(t)hese market rules are not intended to regulate anti-competitive behaviour by Market Participants which, as in all other markets, is subject to the relevant provisions of the Trade Practices Act, 1974 and the Competition Codes of participating jurisdictions."

It is arguable that the intention of the Code expressed in clause 3.1.4.(b) binds NECA because it constitutes a "duty" and/or an "obligation…imposed by the Code." The express intention of clause 3.1.4 (b) is that the Code is not to regulate anti-competitive behavior, and, accordingly, this intention may impose a duty on NECA not to so regulate- especially where in its review reports and Issues Paper NECA seems to assert that its "bad spikes" are a result of non competitive conduct.

Clause 1.4 of the Code provides that the objectives of the Code are, inter alia:

"(1) to provide a regime of 'light-handed' regulation of the market to achieve the market objectives;"

First, it is arguable that the proposed clause 3.8.22A (b) cannot be characterised as "light handed" regulation. The proposed amendment is a reversal of the fundamental common law principle of the presumption of innocence until proven guilty which, it is submitted, is a "heavy-handed" attempt to regulate the market.

Secondly, clause 3.1.4 (b) provides that the Code does not intend to regulate anti-competitive behaviour.

Accordingly, it is arguable that the proposed clause 3.8.22A (b) is contrary to the express intention of the Code under clause 3.1.4 (b) and for that additional reason, does not constitute "light handed" regulation of the market.

4. The "Conduct Prejudicial" Code Changes.

The code objectives in respect of market efficiency are very clear.

> "to provide a regime of light handed regulation of the *market* to achieve the *Market Objectives"* 1.4(b) 1, with *Market Objectives* as "the *market* should be competitive", 1.3(b) 1

Equal treatment should be provided to

New entrants and incumbents	1.3(b) 4
Fuel or technology sources	1.3(b) 5
Intrastate and interstate	1.3(b) 6

NECA's contention appears to be that some market events are affecting the competitive nature of the market, particularly those taken from its evidence to the South Australian Electricity Taskforce, i.e.

- Conservative transfer limits across interconnectors
- Restoration of secure operating state within 5 minutes rather than within 30 minutes
- Drafting of the constraint equations
- Use of network services.

The NGF supports the principles behind these changes and the actions outlined in the Code Change Panel Report on pp4-6. However, the NGF is concerned with the potential of the 5-30 minute change to allow the grid to be in (by definition) a non secure state for longer and therefore increase the exposure to cascade events. This change is also inconsistent with the continued evolution of the pool towards more real time operation.

NECA then goes on to discuss price effects of the generators bidding response to either demand variations or competitive conditions. Paraphrasing the report and the 24 May issue paper, these fall into two groups.

Price effects relating to extreme events include

> 4 Feb 1999 – Extreme conditions in Victoria and South Australia
>
> October 2000 – Constraints on the VIC – SA interconnector
>
> 27 Nov 2000 – Short notice events in SA

Price effects relating to value in the pool not (apparently) at system extremes

> Victoria – 18-24 Feb 2001

> NSW – 4 August 2000

and assertions as to the appropriateness of

> "must run provisions of the market system " when it would have been more appropriate for them to have made straight & forward energy bids" (Volume 1 Report, p6)

These events are then used to construct a code change that prohibits bids or rebids that have the purpose or effect of materially prejudicing the efficient competitive or reliable operation of the market without reasonable cause.

The NGF is of the view that NECA's current surveillance powers and systems, and NEMMCO's powers of direction are sufficient to deal with any actions that may prejudice of reliable operation of the market, that is, actions that may affect system stability or security.

The guidelines accompanying the execution of these powers are not included in this authorisation. The NGF considers this totally inappropriate, in that the guidelines go to the core of the price fixing prohibition contained in S45 and exclusionary provisions of s4 and s45 of the *Trade Practices Act.*

The NGF are of the view that the wording of the draft guidelines contain the core of NECA's assertions on these market events.

> *The sorts of actions that, in NECA's view, may have the effect of materially prejudicing the efficient, competitive or reliable operation of the market include:*
>
> - *Withholding capacity from the market in order artificially to increase prices;*
> - *Establishing the circumstances where high priced 'sleeper' bids or rebids are dispatched;*
> - *Exploiting network constraints or rebidding following reductions in generating or network capacity or increase in demand, in a manner that is wholly disproportionate to changes in actual or opportunity costs; and*
> - *Manipulating dynamic capability.*
>
> *Source NECA Draft Guidelines, Sept 2001*

The NGF have taken the view that neither in NECA's report, nor in the Code change proposal has there been demonstration of the meaning nor credible diagnosis offered of

- Artificial price increase and the competitive element or efficiency reduction associated with these increases

- Circumstances causing bids (of whatever type) to be dispatched which then result in (presumably artificial) higher prices
- Exploiting changes in system, network demand or supply conditions resulting in artificial / higher prices
- Altering dynamic capability and its (inappropriate) affect on price.

Price

The NGF is deeply concerned that these proposals may be an attempt to remove price volatility that is a key underlying value driver of the NEM.

In our submission to NECA on the prohibitions proposed in NECA's original consultation (specifically the 3hr proposal) we said

> *If the 'problem' is one of a perception of misuse of market power, it is a matter of law and economic common sense that market rules will not eliminate its effect. Structural change to the market is the proper mechanism for rectification of market power imbalance. NECA does not have the remit to examine or control price. The ACCC has statutory power to review and prosecute misuse of market power.*
>
> *The NGF is not satisfied that NECA has not acted ultra vires in proposing Code changes whose initiation appears to have been based on a desire to regulate price outcomes.*
>
> *Any effected person can take action under s46 of the TPA and the NGF is not aware of any current actions under s46 that would illustrate a potential problem with market power in the electricity industry, or failed actions that would illustrate the need for rectification to the authorisations as proposed by the NECA as above.*
>
> *The NGF is not aware of comment by the ACCC expressing concern as to market outcomes, indeed, the ACCC, has commented to the contrary in recent times. The NGF is of the view that the market has been appropriately signalling the requirement for investment in a number of regions and seasons, in the type of generation called for in the statement of opportunities over the last 3-5 years.*

These concerns remain.

UK Market Rules

OFGEM, has attempted (twice) to introduce these concepts in the UK generation licences, and has been referred to as a source of the proposals. The NGF draws to the ACCC's attention the rejections of the first proposal by the Competition Commission[4], under similar tests as would apply in Australia.

[4] Previously the Monopolies and Mergers Commission

In addition to the comments made by the CC in its rejection of the proposals[5] , the NGF note that the UK Pool Market is radically different to Australia:

	UK	Australia
No of Regions	1	5 (at present)
Pricing by MSO	Close off 3 hours prior to dispatch, to solve for constraints occasioned by single region	Close off 5 minutes, only intraregional constraints solved by SPD
Impact of constraints	Major	Minor

The NGF contends that the majority of concerns expressed by the OFGEM relate to the situation where there is no inter-regional market. Competitors and customers cannot therefore react to these price signals. This continuation of the single region model in the UK by definition eliminates the very dynamic that is the inter-regional market in Australia.

The NGF considers that OFGEM's attempt to prevent constraint pricing in the UK is not a precedent for the altering of competitive outcomes in Australia.

5. Basis of Competition in the NEM.

NGF's considers that the Code changes proposal radically confuses a lack of ½ hour by ½ hour (or intra day) response within the pool with a lack of competitive response. This seriously mistakes the competitive dynamic operating in Australia.

Firstly, the pool itself enables response. In the 24 May Issue Paper, NECA several times refers to disparities between adjacent dispatch intervals (ie 0700 vs 0730 on 4 August 2000). The paper also refers to the bidding structure of one participant (at pages 5 and 6) with a " bid structure that persisted until the end of March"

In this report, NECA appears to contend that the bid structure it graphs for that participant for the 3 days of the graph had a direct affect on the peak price, that is the spike on the first day. While the latter structure **may** have had the effect suggested on 19 and 20 February 2001, supply and demand did not create changes in pricing or the dispatch of that participant at other times despite the continuing presence of the (allegedly inappropriate) bid structure.

[5] http://www.competition-commission.org.uk/reports/fulltext/453c4.pdf

In fact, this bid structure served to lower price as more volume was put back on the majority of days during this period. To take the case further, it could also be argued that this bid structure was beneficial to the market as it was consistent (and predictable) and presented a view to the market of the top end to prices for each day. This provided market participants the opportunity to asses their possible exposures and take appropriate (demand or supply) action well before the settlement interval.

The former NECA example clearly illustrates the effect and importance of the ability of pool participants to react in short timeframes, limiting the effective period of any (appropriate or inappropriate) structure.

As we will argue below, the very short term volatility of supply and demand in Australia will both lead to and require price and valuation effects to be concentrated into short duration pool events. The price response to those effects will however relate to their **valuation** by the market, not the cost position of the particular participant singled out (too often incorrectly) by NECA.

Secondly, the vast bulk of the effect on other participants (generators, retailers and traders) will depend on their risk management structures. While in its report NECA posits good and bad price spikes, price spikes are a fundamental aspect of the Australian system due to

- Demand spikes
- Forced or planned plant outages (transmission or generation)
- Weather effects
- Unexpected conjunctions of the above.

While NECA attempts to argue that all price spikes should relate only to underlying physical causes, price is a function of physical cause and participant's competitive response. The latter is an important element of both pool value and participant commercial value. Participant risk management systems, using the OTC market and in-house generation, should operate to protect retail and generation commercial interests from the price effects (or lack of effect) of a conjunction of supply and demand or competitive responses and positioning.

Those participants who are not protected have therefore **chosen** to participate in the underlying dynamics of the pool. It should be not be Code's role to provide insurance for these participants should their decisions prove wrong. It has not been demonstrated, to any level of analysis, that the intervention in the valuation of the risks of the pool occasioned by the proposed guidelines should be reduced. The NGF suggest that given the commercial size of these participants that this is a very high hurdle indeed.

Thirdly, NECA has failed to demonstrate that the "bad spikes" it discusses in its May 24 issues paper had any adverse effect on the pool or other markets. It provides no evidence from retailers or generators or traders that these (allegedly excessively) priced events have harmed a competitor, or raised prices for a customer.

A theoretical link between underlying pool volatility and the premium paid for a contract can be constructed, if the OTC market correctly values the underlying risk of operating in the pool. The NGF argues the OTC market will be among the most competitive of the commodity markets, due to:

- A complete absence of barriers to entry to the OTC market (taking the NEM as a whole)
- Homogeneity of hedge instruments (ie. predominance of the ISDA form, commonly traded tenor and size, and absolute commonality among the character/value of hedges sold by different participants), and
- Commercial drivers of most market participants

Given therefore the assumption that the underlying volatility would be competitively and correctly valued in the OTC instruments, any case for regulation of rebidding needs to establish that the "very few" events significantly disturbed the OTC market in order to adequately argue any customer or economic detriment.

The following table shows the OTC price for a nominal 5 or 10 MW 12 month forward trade in the OTC market. The next 12 months (NSW, Vic or SA) is a very commonly traded instrument, as is the balance of financial year (BOFY").

Table 1. OTC Forward Prices

NECA Report, Event date	**Market**	**Price Friday Prior A$/MWh**	**Price Friday After A$/MWh**	**Impact A$/MWh**
4 February 1999	NSW	29.00	28.50	-0.50
4 August 1999	BOFY NSW	30.90	30.91	+0.01
27 November 2000	SA			
	VIC	28.05	28.05	-
24 February 2001	VIC	26.71	27.07	+0.36
11 January 2001	NSW	N/A		
22 January 2001	NSW	27.75	27.13	-0.52
21 February 2001	NSW	39.30	39.00	-0.30

Source: Yallourn Energy

It can be seen from the above table, that taking the dates of the events observed in NECA's 24 May issue paper, firstly that prices in the 12 month forward Contract

market dropped after all of the events (except 4 August 199 (+$0.01) and 27 November 2000 VIC-Steady). Secondly the price variations between these events far outweighed the price variations at these events.

The proposed amendment that would prohibit a bid or rebid that has the purpose, or has or is likely to have the effect, of materially prejudicing the efficient, competitive or reliable operation of the market, purports to treat a particular act (ie a bid or rebid) as the cause of a long term market consequence.

Sections 45 and 47 of the *Trade Practices Act* combine conduct in a longer term context with the likely effect upon competition in a market. For example, for a contract or arrangement to have the effect of substantially lessening competition in a market, it would need to be a contract or arrangement the provisions of which are sufficient (whether in terms of duration, exclusion or otherwise) to be capable of having an effect upon competition in that market (which is a long term concept).

However, to suggest that a particular bid itself (which is conduct of an instantaneous and discrete nature) is capable of having the proscribed purpose or effect, appears to confuse (and purport to combine) very short term conduct with long term outcomes. It may be that a series of bids or rebids, whether alone or in combination with others, could, over time, send distortionary pricing signals which have an effect upon the market (including deterring new entry or extension or expansion by existing participants), but that is fundamentally different from the proposed amendment to the Code.

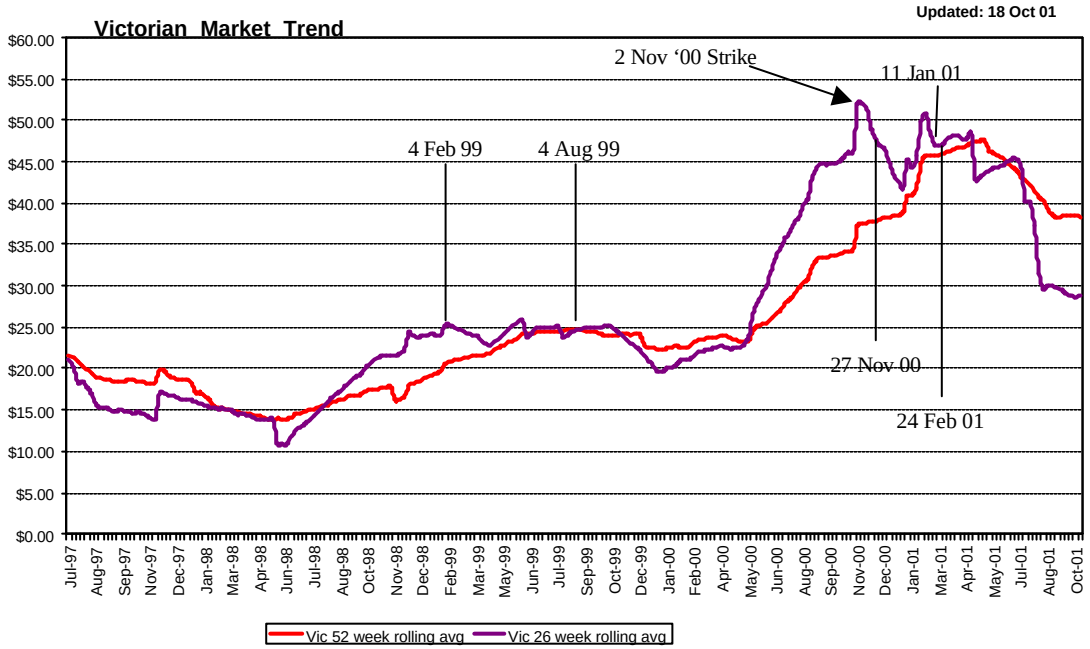
The previous section provides data to clearly show that the "events" of concern highlighted in NECA's 24 May Issues Paper had little impact on the market, that the ability of any bid to persist in its "effect" is extremely limited and the section on long term pricing (below) demonstrates that the "events" did not affect the average pool price. The concept central to the changes, that a bid can have a long term (detrimental) effect to the NEM, is fundamentally flawed.

6. Efficiency of NEM

The NGF argues that the proposed onerous code changes are unnecessary, since the Market has not exhibited inefficiency due to their absence at this point in time.

Long Term Pricing

The long-term trends in pricing have not been such as to exhibit the earning of monopoly rents in the pool, ie. prices are consistent with or lower than long run marginal cost, with new entrant prices taken as a proxy for LRMC. The following graph shows the 26 week and 52 week rolling average Victorian pool price for the period since June 1997.



The 26 week curve can be observed crossing the $40-45 in August September 2000, and the 52 week crossing that area in December-January 2001. With $40-45 taken as an estimate of new entry pricing[6] the pool can be seen to be strongly signalling new capacity in Victoria related to the Summer of 2001. Since this time 1000 MW of open cycle capacity has been announced for Victoria and South Australia, and the curves have dropped below $40 and $30 respectively. It is noteworthy that despite repeated "calls" for new capacity in these regions in the 1999 and 2000 Statement of Opportunities (SOO), the announcements followed the pool signal not the SOO.

It can also be observed from the curves that the dates noted in the 24 May report do not correspond to major pool price average disturbances – they therefore **do not** correspond to "artificial" prices or inappropriate price outcomes.

Short Run Pricing

Does short run pricing in the market exhibit characteristics that suggest the earning of market inefficiency rents? Our arguments (above) depicting the pool and contract

[6] A report commissioned by Macquarie Generation from SKM in October 2001 estimates LRMC for a range of plant possibilities at $0.51 AUD/USD at $37-39. Other recent estimates have LRMC priced in the low to mid $40's.

market response to the identified events strongly suggest that the short run pricing "spikes" are a natural result of Australia's:

- Long thin network between major load centres (and therefore exposure to shocks from transmission or regional generation failures.

- Highly volatile demand response to weather, be it Victorian or South Australian summer air conditioning peaks, NSW winters or the emerging NSW summer air conditioning features.

- Combinations of the above.

7. Conclusion – "Conduct Prejudicial" Code Changes

In conclusion, the NGF argues that:

- The pool response (to any) short term perturbation is an effective competitive response to the demand, supply and competitive conditions ruling at that time

- While NECA is the pool Code Administrator, the competitive market is the Contract and Pool markets (as well as insurance and other derivative markets) – which adequately protect prudent corporates from any extremes or excessive price impacts

- The events noted by NECA had no effect on the contract market, and therefore are treated by the market as normal events.

- These events did not have any discernible effect on pool average prices

Therefore the NEM views these events as appropriate valuation of the physical events and competitive conditions ruling at the time, and thus insufficient to suggest a need for the heavy-handed regulation incorporated in the proposed Code changes.

The NGF has argued that these proposed Code changes potentially offend sound legal and Code principle, and risk market efficiency and reliability. Given then that the analysis demonstrates no discernible market effect from the alleged behaviours which these Code changes seek to regulate, the NGF proposes that the Commission is faced with a Code changes which have no appreciable benefit, but substantial actual and potential detriment to market efficiency, investment and reliability.

The NGF therefore strongly recommends that the Commission rejects the proposed Code changes in full, and instead reiterates the sufficiency of the current market surveillance and Trade Practices regulatory framework for the market.

Finally, the NGF reiterates its preparedness to assist both NECA and the Commission in the development less damaging approaches to ensuring that the market retains its integrity, should market failure be demonstrated in the future.