



October 26, 2001

Mr Michael Rawstron
General Manager
Regulatory Affairs – Electricity
Australian Competition and Consumer Commission
PO Box 1199
Dickson ACT 2062

Dear Mr Rawstron,

Re: Authorisations - National Electricity Code Changes Rebidding Rules

EnergyAustralia is pleased to be able to provide comment on this matter. It is our opinion that this issue requires urgent attention, otherwise, the capacity of the National Electricity Market to deliver effective full retail competition will be reduced. Full retail competition represents a critical phase in the ongoing development of the NEM and the rules governing the price setting mechanism will have a significant bearing upon the benefits delivered by this reform.

Our view is that the current bidding rules are, in some instances, preventing the underlying dynamics of the market from setting efficient price outcomes. Consequently, these rules provide a means of manipulating price outcomes. As the energy market is becoming more complex, the incentives for such interference in the underlying dynamics is more pronounced. Examples of this increasing complexity include the new market in Frequency Control Ancillary Services and the pressure for market participants to align their financial contract exposure to their physical position, as the market cap moves to \$10,000/MWh.

There will be two parts to our submission. Firstly, we will provide our thoughts on the proposed code changes under consideration with reference to the public benefit. In the second part, we will provide the Commission with an alternate approach, for your consideration.

Turning to the proposals currently before the ACCC. Our opinion on the proposed code changes is that they will be unworkable and as such will produce little change. We base this premise on the following;

- **The volume of rebidding activity.** In market research released by NECA, between November 2000 and April 2001, there were on average, around 800 rebids a day across the entire market. The relevance of the period should not be lost, as it covered a summer that was characterised by record spot prices, exceptional volatility; - with the subsequent flow through to higher forward contract prices. In essence, it is the forward contract coverage, that a retailer can obtain, that drives retail electricity prices. The report found that total rebidding activity was up 20% compared to the same period the prior year and that in some jurisdictions the comparison was as high as 60%.*

Therefore, the period that this research covers provides a useful gauge upon which to evaluate the extent of the rebidding practice and to make conclusions about the drivers behind such activity. It is difficult to conceive that changes to plant conditions could be the total source of this rebidding activity. We will explore this issue more fully, at a latter point in this submission, however, for us, any code change discussions on this subject should start with a clear annunciation on the purpose of rebidding. If the intention is to allow suppliers of energy the flexibility to amend their offers due to changes in plant capability, that were unknown at the time of their initial offer, then clearly the practice has now fallen outside the scope of the mandate.

Given this volume of rebidding activity we believe that it is practically impossible to seek to pursue a market monitoring approach. We believe our view is reinforced by the real time nature of the market, which imposes a constantly changing price, (every thirty minutes derived from five-minute bids), which is in turn a function of numerous and varying dynamics.

It is apparent to EnergyAustralia that NECA has adopted a Trade Practices Act style rationale. However, we find it difficult to envisage how such an approach will have application in the energy market, where the competitive monitoring of a market, as advocated by TPA legislation, is best suited to specific single acts of price collusion and associated anti-competitive behaviour, that can be detected over long time horizons, that exhibit relatively stable price characteristics.

- **A new initiative is required.** We believe that the proposal is simply an extension of the existing rules, of which there is evidence to justify the proposition that these rules have not been effective. The current rules very much seek to foster a spirit of 'fairness' by requiring the rebidder to provide a verifiable and specific reason for the rebid. Our understanding was that the intention of the rules was to draw attention to rebidding that was contrary to the competitive interests of the market. Reasons openly and often

afforded by rebidder's, such as financial optimisation and or price volume trade off, perhaps indicate the level of scepticism that the current rules have attracted, and the flaw in the new rules, which simply seek to build on an evaluation of the disclosures made to support the rebid.

- **Evidentiary obstacles.** Under the proposed code changes NECA will have the power to request information from the market participant, if it suspects that the actions of the participant have prejudice the competitive operation of the market. The effect of this will be to require the market participant to show reasonable cause or justify that their actions were not a deliberate attempt to undermine efficient market outcomes.

Such a change may be thought to be an improvement, by requiring an alleged abuser to defend their actions, by a 'shifting of the burden of proof' away from NECA. However, we would argue that such an initiative adds little value. Any examination of this nature will undoubtedly bring into consideration defences that the rebid was made to protect operating plant and was thus done in accordance with, 'Good Electricity Industry Practice' (GEIP). Determining the appropriateness of such defences possesses significant evidentiary hurdles upon which to counter. Reference is made to a report by the Office of the Regulator-General of Victoria, when it was required to consider a Force Majeure determination relating to the Loy Yang B outage in May last year. It stated that, in determining if GEIP had been adopted, "In short, the office believes that this is an inherently difficult assertion to prove or disprove". The report also found that investigations (*to determine GEIP*), "to be lengthy and a resource intensive exercise".^

- **Lack of deterrents.** Like any measures that seek to influence a participant's behaviour under threat of investigation, they must be supported by adequate penalties that will serve as a deterrent. Under the proposed code changes there is no reference to the penalties that anti-competitive behaviour will attract. Our last recollection of such discussions was that NECA was moving to instigate a Code of Ethics that sought to publicise acts of deemed abuse. Further, EnergyAustralia is not aware of any instances of market participants being found to have breached the National Electricity Code and subsequent enforcement of penalties.

It should be clear from the above, that the substance of these code changes is reactionary in its nature. When consideration is given, amongst other things, to the volume of transactions that NECA is seeking to monitor and then the difficulty it will face when seeking to impose penalties, such a strategy will become frustrated by the practical issues of implementation.

We believe that the better approach would be to ensure that, in the first instance, such practices that lead to potential anti competitive outcomes are prevented per se.

Foremost, NECA needs to identify and establish a clear objective as the purpose of its rebidding rules. There should be no confusion as to the rights and obligations afforded under these rules. We are of the view that such a statement still remains lacking. Evidence of this can be found in the history of the proposed code changes and the guidelines surrounding the current rules. All the current guidelines seek to achieve is a flow of information to both NECA and NEMMCO, nothing is said of what constitutes unacceptable practice.

It would appear that a number of market participants are under the belief that rebidding to set price at close to VoLL is acceptable. EnergyAustralia has difficulty reconciling reasoning such as ‘financial optimisation’ with changes to a generator’s plant availability.

EnergyAustralia therefore believes that as a minimum, a generator’s bid should be locked down for at least 5 minutes prior to the following 30 minute trading interval. In instances of plant failure and where the generator has available plant unaffected by an outage this plant should be made available to substitute the plant that has been lost, to the lowest offer. It must be well understood by all market participants that this is the sole function of the rebidding provisions, being an ability to realign offered capacity due to changes in physical operating conditions.

In order to ensure that suppliers can provide bids into the market that reflect expected market conditions, EnergyAustralia would argue that a degree of certainty and confidence is currently lacking. This could be remedied by enhancing market transparency. We point to the following examples, where improvements could be made;

- **Improve information contained in STPASA and MTPASA.** It is often noted that the information contained within both STPASA and MTPASA (NEMMCO’s demand forecasting systems) is at times unreliable. PASA should not be open to abuse by generators using market power to distort forward price expectations by either withholding or dumping capacity. Generators should be required to publish all information through NEMMCO detailing maintenance schedules, plant movements and other relevant information, thus permitting greater market transparency.
- **Improve short-term (pre-dispatch) forecasting.** NEMMCO’s performance in this area, has at times been brought into question. Improvement will provide for greater accuracy in the pre-dispatch, thereby providing the market with appropriate price signals and reducing the need to for suppliers to react to ‘last minute’ changes in market conditions.

With recent market developments that have resulted in the emergence of parallel markets, like the separate market for the provision of ancillary services, EnergyAustralia believes an important guiding principle needs to be established. That being, that those responsible for overseeing the introduction of these markets, will ensure that code changes are consistently applied and will ‘work’ across both markets equally, and will not favour one market at the expense of the other.

We hope we have been able to provide constructive input on these matters and would welcome the opportunity to further elaborate on any part of this submission with the Commission, at your request. We can be contacted on 02 9269 2920.

Yours Sincerely,

Tim O'Grady
General Manager –Energy Risk Management

References

* NECA, Bidding and rebidding strategies and their effect on prices, Issues Paper, Pages 1 - 2, May 2001.

^ Office of the Regulator-General, Victoria, Loy Yang B Force Majeure Determinations and Approach Paper, Pages 11-12, July 2000.