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31 October 2001

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

Dear Michael,

**Re: National Electricity Code Changes - Bidding and Rebidding Rules**

**1.0 Introduction**

InterGen (Australia) Pty Ltd ("InterGen") welcomes the opportunity to comment on the National Electricity Code Administrator ("NECA") application for authorisation of changes to the rebidding rules contained in the National Electricity Code ("the Code") to the Australian Competition and Consumer Commission ("ACCC").

InterGen is an active member of the National Generators Forum ("NGF") and endorses the submission and representations made by the NGF on the matter of Bidding and Rebidding Code changes. This submission is intended to discuss key points that are of critical concern to InterGen.

NECA has stated that the proposed Code changes are aimed at:

- tackling directly the inefficiencies that have led to the very short-term price spikes experienced in the NEM and that have no basis in the NEM's underlying dynamics;
- requiring generators' bids and rebids to be made in good faith; and
- specifically addressing those aspects of generators' bidding and rebidding strategies that give cause for concern by imposing a prohibition on bids and rebids that materially prejudice the efficient, competitive and reliable operation of the NEM.

NECA has subsequently published draft Guidelines that underpin the Code changes and are intended to highlight the sorts of actions that, in NECA's view, may breach the proposed prohibition. Those actions include:

- withholding capacity from the market in order to artificially increase prices;
- establishing the circumstances where high-priced 'sleepers' bids or rebids are dispatched;
- exploiting network constraints or rebidding following reductions in generating or network capacity or increases in demand, in a manner that is wholly disproportionate to changes in actual or opportunity costs; and
- manipulating dynamic capability.



InterGen understands that the Guidelines are not intended to be submitted to the ACCC for authorisation as part of the bidding and rebidding Code changes.

InterGen's concerns relate to the following issues:

- NECA has not articulated or demonstrated what the alleged problem sought to be resolved by the Code change proposal is;
- the proposed Code changes are not consistent with the objectives of the Code;
- the introduction of the concept of use of Guidelines that are not subject to the Code change process;
- the unprecedented reversal of the onus of proof;
- the introduction of an undefined concept of "Good Faith";
- the significant introduction of further sovereign/regulatory risk into the NEM; and
- the concept of inappropriately importing UK Regulatory language into the NEM.

Each of these matters is discussed in the following section.

In InterGen's view, a market should be allowed to respond first. Regulatory intervention should be the last resort and should be specifically and clearly aimed at a systemic problem of either abuse of market power or a fundamental flaw that prevents the market from responding.



## 2.0 Discussion

This section discusses each of the points identified above.

### 2.1 Articulation of the “Problem”

The rationale provided by NECA for the Code changes does not involve any clear articulation of the alleged problem. InterGen notes that this question has been put to NECA on several occasions during the Code consultation process, however no direct answer has been received. In a meeting with NECA on 23 October 2001 the NGF attempted to derive the “problem” via market based examples however, Stephen Kelly would not be drawn on what circumstances define the problem being addressed by the rebidding Code changes. The NGF and InterGen are left with the suspicion that alleged abuses of market power and/or price volatility are NECA’s issues but are concerned that the proponent of the Code changes is unable or unwilling to articulate the offensive behaviour that its Code changes are intended to address.

In terms of process for a Code change proposal, InterGen finds it extraordinary that NECA has not produced any analysis of the perceived problem and where the rationale is presented it is an anecdotal form, that is in our view, inadequate. NECA appears have relied entirely on its own market reports and its Rebidding issues paper to allege:

- gaming of interconnectors;
- gaming the market to have “sleeper” bids dispatched;
- withdrawing capacity from the market;
- inappropriate ramp rate changes; and
- inappropriate bidding/rebidding.

InterGen is concerned that the NECA market reports have a critical deficiency in that they deal with a few non systemic events that have recently occurred in the market, all of which are events that we would argue appropriate market responses have occurred. We would consider that appropriate evidence that would warrant Code change for bidding and rebidding rules would include:

- an analysis of long term incentives for efficient investments in the NEM;
- an analysis that established a sound theoretical model of short run pricing compared with an analysis of actual generator pricing behaviour;
- an analysis of the factors that contribute to NEM price volatility;
- an analytical treatment of what is meant by excessive volatility;
- establishment of an appropriate basis for measurement of price volatility and measurement on that basis; and
- analysis of costs and benefits associated with price volatility.

### 2.2 Objectives and Principles of the Code

InterGen considers that any proposed changes to the Code should comply with the objectives of the Code as it is currently authorised. The objectives were identified in the market development process after careful consideration and in our view are clearly stated.

The market objectives are set out in clause 1.3 of the Code, reflect in our view, the presumption that abuses of market power are best remedied through the enhancement of competitive responses. The NECA approach in its proposed Code changes breaches this presumption through premature regulatory intervention rather than allowing the market to react first. Further NECA has not observed the market design principles for the market rules clause 3.1.4 that include:



“minimisation of NEMMCO decision making, to allow Market Participant the greatest amount of commercial freedom to decide how they will operate in the market.”

InterGen is most seriously concerned that NECA has not been mindful of clause 3.1.4(b) and the role of the ACCC and TPA that provides that:

“...these market rules are not intended to regulate anti-competitive behaviour by Market Participants which, in all other markets, is subject to the relevant provisions of the TPA ....”

Finally, the proposed Code changes do not appear to be consistent with the first two objectives of the Code in clause 1.4(b):

“To provide a regime of light handed regulation of the market to achieve the market objectives; and  
To provide for a set of market-oriented rules authorised by the ACCC governing market operations, power system security, network connection and access and network services pricing.”

The above analysis indicated that the proposed Code changes contradict the objectives of the market. They appear designed to elevate NECA to the role of electricity industry economic regulator and to regulate alleged anti-competitive conduct by imposing unnecessary and uncertain restrictions on how Market Participants can operate in the market.

### 2.3 Guidelines

InterGen is of the opinion that the application for authorisation before the ACCC is incomplete without the inclusion of the Guidelines that underpin the application. The ACCC should not consider the application in relation to proposed clauses 3.8.22, 3.8.22A and 3.8.22B of the Code if it does not have access to the final Guidelines to support the proposed changes to the Code.

In discussions between NECA and the NGF on 23 October 2001, Stephen Kelly specifically commented that :

- the draft Guidelines were “first draft” and were rushed;
- they were published to be in line with the rebidding Code changes but acknowledged that they will need to be amended; and
- noted that feedback had already been provided by market participants that:
  - the reversal of onus of proof was a problem;
  - the Guidelines need to be much more specific; and
  - participants were concerned that the Guidelines can be readily changed by NECA via a process less substantial than the Code change process.

InterGen contends that the ACCC cannot make an informed and rational assessment of the proposed Code changes unless they have access to the final Guidelines as these will form a critical element of proposed amendments. We consider that the Guidelines in any event are flawed as they are currently drafted as they should provide objective rather than subjective criteria to assist market participants to comply with the Code across their bidding and rebidding activities. The draft Guidelines, by identifying only a limited number of circumstances in which NECA currently considers that the prohibition would be breached, do not provide market participants with any general guidance or any regulatory certainty.

The introduction of the concept of Guidelines is in our view not contemplated in the NEM design, is unprecedented as a Code development and introduces a significant and unwarranted level of regulatory risk. Our view is that if the matter is important enough to require clarification via a Guideline, then the matter should be fully considered in the drafting process and appropriately codified. The status of the Guidelines is also an issue as a document that requires a lesser standard of justification to change. We consider it inappropriate that the Guidelines are not subject to the same standard of proof of case and justification for change as any other part of the Code.



The Guidelines are by nature subjective, readily changed and import into the NEM two unknowns in the form of:

- NECA's current and potentially often changing view of "appropriate" market prices; and
- a NECA defined test of abuse of market power.

InterGen is concerned that NECA has confused its mandate with a role that is clearly that of the ACCC. NECA is not the economic regulator of the NEM, it is the Code administrator with a clear and defined charter.

We consider that in the context of section 91B of the Trade Practices Act, future changes to the Guidelines (once finalised) will have the potential to amount to a material change in circumstances that will be the basis upon which market participants may argue that the ACCC should revoke any current authorisation for the rebidding Code changes. We consider this prospect to be extremely unfortunate as it provides further regulatory uncertainty.

Further, even though it would seem that NECA believes that the Guidelines will not form part of the Code, and therefore do need authorisation, we are of the view that there is a danger that because the Guidelines, at least in the current draft, are so poorly defined, Market Participants who apply the Guideline principles will not necessarily be immune from TPA action unless the Guidelines are specifically authorised by the ACCC. In particular we are concerned that a party who complies with or follows the Guidelines may inadvertently be involved in an arrangement or understanding that breaches section 45 of the TPA, especially in relation to price fixing or boycotting behaviour.

## **2.4 Good Faith**

In the context of bidding and rebidding in proposed clause 3.8.22A – "variation of offer, bid, or rebid", NECA has introduced into the Code the concept of Good Faith. The term Good Faith however is not defined.

We note that this expression is sometimes used in relation to consumer protection and consumer related transactions, however we are unaware of any precedent to consider this concept in relation to commercial transactions. The legal standard applied to most laws ordinarily adopts objective standards or criteria that are capable of assessment and application ex ante to facilitate compliance. There is no objective test in the proposed Code changes and the concept of Good Faith therefore can only be assessed by a court understanding the mental state or thinking of the person engaging in the conduct in question.

The lack of objective criteria therefore introduces a problematic concept for market participants and creates considerable regulatory uncertainty as there does not appear to be a consensus of law as to what the concept of Good Faith involves in commercial transactions. As the proposed Code changes and Guidelines provide no insight as to what circumstances the concept is to be used by NECA in relation to complex commercial transactions, we assert that the Code changes should be rejected on the basis of the introduction of unnecessary market inefficiency and regulatory uncertainty.

## **2.5 Reversal of Onus of Proof**

The NECA proposed clause 3.8.22B shifts the onus under proposed clause 3.8.22A from the complaining party to the defendant.

The practical implication of the proposed Code change is that for all market activity, a generator could be required to satisfy the National Electricity Tribunal that its bid or rebid was genuinely made in Good Faith rather than the reverse. InterGen's main concern is that NECA does not need to establish a prima facie case, it needs only to assert that a bid or rebid was not made in Good Faith. The effect is



to deem a participant guilty of an offence (and penalty) without reference to the whether the facts are proven or otherwise.

We note that NECA refers to section 51A of the TPA, as a precedent where the onus of proof is reversed. InterGen's view is that NECA is using this reference out of context as this section of the TPA is contained in the consumer protection part of the TPA and not directly related to regulating commercial transactions. Section 51A does not relate to any notion of Good Faith and the wording of the section shifts only the procedural or evidentiary burden of proof not the legal burden of proof. This is significant as it creates the presumption of guilt until proven innocent.

In addition, NECA has not considered the legal principle that the level of proof required to satisfy a tribunal or court should generally depend on the severity of the consequences. Given the severe consequences for any market participant who breaches the Code, in our view, breaches should not be deemed but should require proof to the relevant standards. For example, the consequences of a class "A" penalty is \$20,000 per breach, rising to \$100,000 for a class "C" breach under the Code, clearly penalties that are not trivial and have no relationship to the severity.

InterGen is concerned that NECA, whilst proposing that the onus of proof should be reversed, has not established any argument that justifies the need for the reversal and has gone beyond the provisions of S51 of the TPA which it cites as the precedent for shifting both the evidentiary and legal burdens of proof, and has created a presumption of guilt to which severe penalties apply for deemed breaches.

## **2.6 Sovereign Risk**

InterGen's view is that the proposed Code changes are unclear and will be ambiguous in operation, especially if the finalised Guidelines that underpin the Code changes are subject to regular NECA review.

This uncertainty will inexorably result in Market Participants modifying their manner of operation to price in a risk premium such that the market is less efficient than its current design. Due to this endemic form of embedded sovereign risk, the long term costs of electricity for consumers can logically therefore be expected to rise as investors require higher rates of return to cover off the inherent uncertainty in the NEM.

## **2.6 United Kingdom Regulatory references**

The proposed Code changes are advised by NECA appear to be based on language drawn from proposed OFGEM license conditions in the UK market known as the Market Abuse License Conditions ("MALC"). Whilst broadly based on UK license provisions that have not been approved by the UK regulator, they import inappropriate and onerous concepts without any market consultation to determine if they are suitable for the NEM market design. Further, regulatory safeguards proposed in the MALC proposal have not been considered or transplanted with the language adopted.

We note that on their first submission, the MALC provisions were rejected by the UK Competition Commission who were concerned that that the burden of proof should lie with OFGEM to demonstrate that the offensive behaviour had material effects in the market not the reverse. The Competition Commission was also mindful of the degradation of regulatory certainty that the MALC proposal would have introduced to the market.



### 3.0 Conclusion

InterGen considers that the Code changes appear to be initiated on the basis the NECA wants to regulate price outcomes in the NEM. We are not aware of any remit to examine or control price, an area that is clearly an ACCC function and a key structural feature of the current market design.

It appears that NECA does not have faith in competitive efficiency and has decided to resort to heavy handed regulation to address perceived structural issues within the NEM that it has not been able to produce any articulation or credible evidence actually exists. Whilst we surmise that the problem being addressed is abuse of market power and/or price volatility, in attempting to limit the effects of price volatility and/or abuses of market power NECA has ironically imposed structural barriers to entry and introduced market inefficiency in the form of heavy-handed bidding and rebidding regulation. The proposed Code changes will limit the ability of a generator to earn returns on their investment and have the knock on effect of imposing a barrier to new investment. This will create a downward spiral in which market based responses to price volatility is diminished and create an environment for greater NECA intervention, an outcome seemingly at odds with the NEM market objective of light handed regulation.

The proposals are inconsistent with the objective of the NEM and the Code. InterGen is of the view that the proposed code changes and Guidelines are unnecessary and that NECA's current surveillance powers are sufficient to deal with any prejudice of reliable operation of the market.

InterGen has previously commented that short-term trends of increasing price and/or volatility are part of the intended market dynamics that provide fundamental and appropriate signals for supply side and demand side investment. We are concerned that the proposed Code changes demonstrate that NECA is not mindful of this basic structural feature of the design of the NEM market, and disturbingly, is attempting to insert its value judgments on participant behaviour and price levels within the NEM. The Code change forms part of an inappropriate and unwarranted regulatory intervention that attempts to deal with transitory, non-systemic behaviour and if authorised by the ACCC will have quite considerable long term dis-benefit to the market in the form of reduced investment.

Consequently, InterGen recommends that the proposed Code changes should not be authorised.

Yours Sincerely,

  
James M. Driscoll  
Managing Director