

Australian Energy Market Commission  
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Submitted online at [www.aemc.gov.au](http://www.aemc.gov.au)

16<sup>th</sup> May 2014

**RE: National Electricity Amendment (Bidding in Good Faith)  
Rule 2014 – Consultation Paper**

AEMC Ref: ERC0166

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ABN 93 197 662 296

Dear Commissioners,

Thank you for the opportunity to comment on the Consultation Paper for the proposed change to the National Electricity Rules (NER).

As the peak body for the community services sector in South Australia, SACOSS has a long-standing interest in the delivery of essential services. Our research shows that the cost of basic necessities like electricity impacts greatly and disproportionately on vulnerable and disadvantaged people. Our advocacy is informed by our members; organisations and individuals who witness these impacts in our community.

The South Australian Government removed price regulation and adopted the National Energy Customer Framework on February 1<sup>st</sup>, 2013. This makes South Australia the only jurisdiction to have both deregulated prices and adopted the NECF. Recent reports by the AEMC<sup>1</sup> and the Victorian Essential Services Commission (ESCV)<sup>2</sup> also highlight that South Australia continues to have both the nation's highest electricity prices and highest rates of electricity disconnections for failing to pay bills on time.

SACOSS maintains a keen interest in ensuring that the rules of the wholesale electricity market align the commercial interests of market participants with the long-term interests of consumers. Please find a detailed submission to the Consultation Paper attached.

We thank you in advance for your consideration of our comments. If you have any questions relating to the above, please contact SACOSS Senior Policy Officer, Jo De Silva on 8305 4211 or via [jo@sacoss.org.au](mailto:jo@sacoss.org.au).

Yours sincerely,

Ross Womersley  
Executive Director

<sup>1</sup> AEMC 2013 Residential Electricity Price Trends [www.aemc.gov.au/market-reviews/completed/retail-electricity-price-trends-2013.html](http://www.aemc.gov.au/market-reviews/completed/retail-electricity-price-trends-2013.html)

<sup>2</sup> ESCV Energy retailers comparative performance report – Customer service 2012-13 Table 3.2, p31 available from [www.esc.vic.gov.au/Energy/Energy-retail-performance-reports](http://www.esc.vic.gov.au/Energy/Energy-retail-performance-reports)

**SACOSS Submission to:**

National Electricity Amendment (Bidding in good faith) Rule  
2014 – Consultation Paper

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**Background**

Participation in the National Electricity Market (NEM) requires generators to submit bids to the Australian Energy Market Operator (AEMO) specifying the minimum price they are willing to receive for volume offered. Following the submission of initial bids, generators may submit rebids to shift the volume on offer to different prices to allow for changing market conditions.

The NER requires that generators make all bids and rebids in *good faith* such that, at the time of making the bid or rebid, the generators must have a genuine intention to honour that bid if the circumstances upon which the bid is based remain unchanged. The good faith provisions were introduced by the Australian Competition and Consumer Commission (ACCC) in 2002 to address aspects of generator's bidding and rebidding strategies that were seen as manipulating wholesale price outcomes in the NEM.

The South Australian Minister for Energy and Resources has submitted this current rule change request following the Federal Court decision handed down in August 2011 in relation to allegations by the Australian Energy Regulator (AER) that Stanwell Corporation had made a number of rebids that it considered were not in good faith. The proponent considers that the Federal Court's interpretation of the good faith provisions is inconsistent with the original policy intent as considered by the ACCC in 2002.

**A South Australian Consumer Perspective**

The AEMC considered the issue of *Generator Market Power* in its assessment of Rule Change ERC0123. Its final determination was to not make the rule proposed by the rule change proponent, the Major Energy Users Inc (MEU), nor make an alternate rule. However, the AEMC published a Fact Sheet with its final determination that focussed on the South Australian situation<sup>3</sup>. The fact sheet states:

*Recognising the potential for substantial market power to exist or be exercised in the future, the AEMC has explored the possibility of making a rule which would confer on the Australian Energy Regulator (AER) a specific function to monitor the wholesale electricity market, but considers there is material doubt as to whether this function is compatible with the existing functions of the AER.*

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<sup>3</sup> Dated 26 April 2013, at [www.aemc.gov.au/electricity/rule-changes/completed/potential-generator-market-power-in-the-nem.html](http://www.aemc.gov.au/electricity/rule-changes/completed/potential-generator-market-power-in-the-nem.html)

*Therefore, the Commission recommends that the Standing Council on Energy and Resources (SCER) consider conferring on the AER such a monitoring function, and add accountability mechanisms to the AER's current information gathering powers in relation to this monitoring function.*

*An appropriately developed monitoring regime is a pre-requisite for identifying at an early stage any evidence that the efficient operation of the wholesale electricity market is constrained by the presence of significant barriers to entry or other features of the industry structure.*

*The monitoring would allow identified constraints to be addressed in the long term interests of consumers based on an understanding of the underlying cause(s).*

*This approach was supported by a number of stakeholders including the SA Minister for Mineral Resources and Energy.*

SACOSS notes that this was discussed again at the December 2013 meeting of the Standing Council on Energy and Resources (SCER)<sup>4</sup>:

**Other matters considered by Ministers: Market Power**

*SCER noted advice from officials on the potential need for amendments to the National Electricity Law (NEL) to introduce a new wholesale market monitoring function for the Australian Energy Regulator (AER). SCER requested officials further define requirements of and approach to a market monitoring function in the NEL.*

These issues are particularly important in South Australia where wholesale and retail electricity markets are highly vertically integrated. Based on market data (from AEMO, ESCOSA and the AER), SACOSS estimates that 99% of retail electricity customers (households and small businesses consuming less than 160 MWh of electricity per annum) are supplied by only 5 vertically integrated energy businesses: AGL Energy (including subsidiary retailer Powerdirect), Origin Energy, Energy Australia, GDF Suez Australia (Simply Energy) and Infratil (Trustpower and Lumo).

The recent Australian Competition and Consumer Commission (ACCC) decision to block AGL Energy's proposed acquisition of the NSW Government's Macquarie Generation portfolio – the largest Generator in the NSW region of the NEM - has also resonated with South Australian consumers<sup>5</sup>. It is now a matter of speculation as to whether South Australian consumers would be so concerned about issues of Market Power had the ACCC made a similar determination in relation to AGL Energy's purchase of Torrens Island Power Station – the largest Generator in the SA region – in 2007<sup>6</sup>.

In 2013 SACOSS partnered with Carnegie Mellon University (Australia) to investigate the role of wholesale market power in South Australian Electricity Prices. The project investigated price spikes of April and May 2013 and complemented the Special Report published by the AER<sup>7</sup>. The project recommended SACOSS monitor the prevalence of wholesale prices in

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<sup>4</sup> Refer to SCER Meeting #5 – 13 December 2013 – Communiqué available from [www.scer.gov.au/meetings/](http://www.scer.gov.au/meetings/)

<sup>5</sup> <http://registers.accc.gov.au/content/index.phtml/itemId/1147200/fromItemId/751046>

<sup>6</sup> <http://registers.accc.gov.au/content/index.phtml/itemId/784137/fromItemId/751043>

<sup>7</sup> [Special report - Market outcomes in South Australia during April and May 2013 www.aer.gov.au/node/21350](http://www.aer.gov.au/node/21350)

excess of \$300/MWh – the market price used as basis for “cap” hedge contracts in the NEM in order to quantify the potential scale of the issue.

SACOSS subsequently purchased a license for the NEMReview<sup>8</sup> software package and analysed the trading intervals (i.e. the half-hourly intervals) where the average price exceeded \$300/MWh for the 5-year period from the Apr-June Quarter of 2009 to that of 2014. It was observed that the nature of the events seem to be changing. Figure 1 shows that the frequency of events seems to have increase while the average turnover in each event has fallen. This suggests a change in market dynamics over time – possibly a reflection of the softening supply-demand balance in recent years.

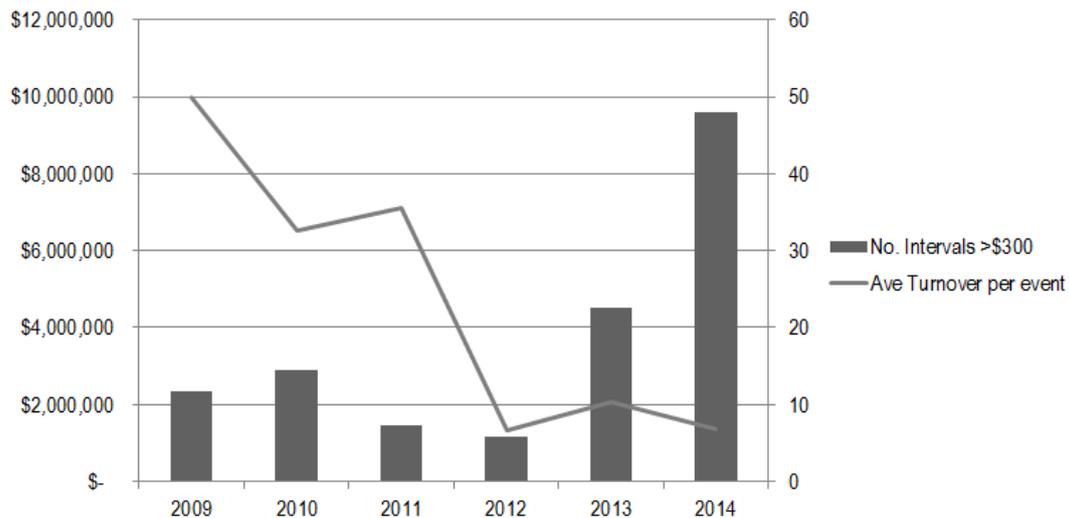
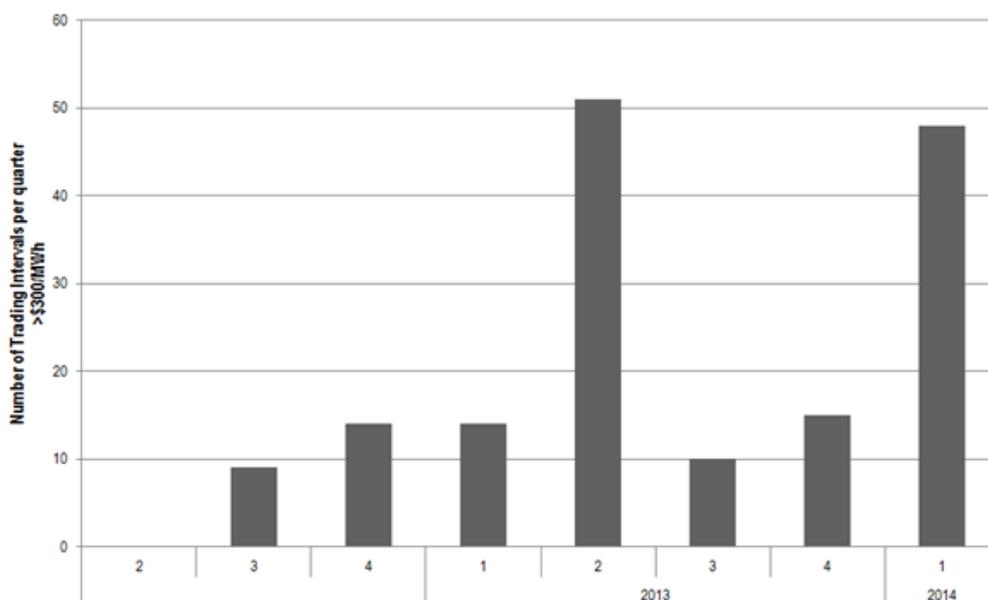


Figure 1: Trading Intervals in excess of \$300/MWh, South Australian NEM Region. Source: AEMO via NEM-Review.

To focus attention on more contemporary market dynamics, we analysed the two years of wholesale activity to the end of March 2014. Figure 2 illustrates the number of trading intervals above \$300/MWh in each of the eight quarters over the two years.



<sup>8</sup> More information is available here: <http://v6.nem-review.info/what/index.aspx>

**Figure 2:** Trading Intervals > \$300/MWh, per quarter, South Australian NEM Region. Source: AEMO via NEM-Review.

Our analysis of this two year period revealed:

- 161 intervals where the price exceeded \$300/MWh - 0.5% of all trading intervals.
- A volume of 175,000 MWh - 0.7% of total volume for the same period
- Wholesale turnover (simple volume x price) of \$270m - 16% of total market turnover

In summary, a very small number of occasions can have a very material impact on wholesale costs over time. It is little surprise then that vertical integration of retail and generation is the business model of choice for the South Australian market's major participants.

This analysis does not suggest that all of these events are caused by the issues canvassed in the rule change. What it does suggest is that intervals above \$300/MWh represent a substantial proportion of market turnover and that, with such a clear commercial incentive, opportunities are being regularly found by participants. In the Consultation paper for the related rule change proposal from the Australian Energy Regulator (AER, Rule Change ERC0165), the Commission is explicit about the need to:

“... consider the risk that altered incentives, or any new technical or regulatory requirements, may lead generators to pursue similar commercial objectives through different means.”

SACOSS has similar concerns. The ability of generators to exercise either transient or sustained **market power** through a variety of means – but particularly the practice of *rebidding* – has been demonstrated to be clearly adaptable to changing market dynamics.

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In short, these issues have a long history. The original good faith provisions were introduced in 2002. The issues raised in the recent AER rule change proposal (ERC0165) are a return to issues tackled in a Rule Change of 2009 (AEMC Ref ERC0065) based on market events in 2005. The MEU's "Generator Market Power" Rule Change proposal stemmed from participant behaviour dating back to 2007. The responses to these issues have consistently deferred to the need for more 'market monitoring' and SACOSS is increasingly concerned about the lack of concrete action.

SACOSS strongly believes that energy market participants as well as the energy market institutions (SCER, AEMC, AER and AEMO) need to be held to account in protecting the consumer interest in these matters and restoring faith in the NEM.

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The Consultation Paper incorporates a series of questions. SACOSS is not in a position to provide a response to the more technical of these questions but does respond to a number of others in the following section.

## SACOSS Response to Questions posed in the Consultation Paper

### Question 1

**Do you consider late strategic rebidding to be the primary issue raised by this rule change request?**

SACOSS can accept the need for rebidding in the market design but agrees that when such rebidding is both *late* and *strategic* it undermines the consumer interest. SACOSS is also of the view that consideration should be given to the related and potentially broader topic of pre-dispatch forecasting as the primary issue. It is possible that the challenges of accurate and reliable pre-dispatch forecasting are what can create the environment for such rebidding practices.

### Question 2

**Do you consider the NEM trading arrangements of five-minute dispatch and 30-minute settlement to be relevant to the issue of late strategic rebidding? Do you have any views as to how any issues arising could be addressed?**

SACOSS agrees that the 5/30 arrangement can provide a clear incentive for rebidding that is both *late* and *strategic*. We are aware that this has been a topic of debate since the very early days of the market.

### Question 3

**Do you consider there to be benefits in the proposed rule to reverse the onus of proof onto generators?**

SACOSS believes that the NEM, now 15 years old, has matured to the point where participants (especially those with the capacity to influence to pricing through their behaviour) can be reasonably expected to accept the onus of proof. The notion<sup>9</sup> that this, "... raises the possibility that a generator may be found to have breached the bidding in good faith provisions simply because it failed to provide satisfactory records, despite the fact that it may actually have had a genuine intention to honour its bid" is to ignore the sophisticated trading capabilities and market knowledge of these participants. Current market participants are highly informed, savvy, sophisticated, vertically integrated profit maximisers with the capability, incentives and shareholder obligations to identify and exploit opportunities to maximise returns.

Rather than this being the case of robust competition that serves the long-run consumer interest, the reality is that when a small number of players repeat the same practices over

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<sup>9</sup> Consultation Paper p22

and over they learn each other's behaviour and adjust their strategies accordingly. The South Australian wholesale market (and the strongly integrated retail market) behaves like an oligopoly and must be regulated accordingly.

#### **Question 5**

**Do you consider it reasonable that all bids and rebids should be made with reference to published AEMO data?**

SACOSS believes that this is appropriate. The accuracy and reliability of pre-dispatch forecasting is a central element to the issues being discussed. By mandating a reference to AEMO published data a clear driver is established to refine this process – for the benefit of both supply side and (current and future) demand side responses.

#### **Question 6**

- (a) What are your views on any of the options discussed above? Do you consider any of these options or any other options around the design of the bidding process to better address the issues raised in the rule change request?**
- (b) Are there any approaches used in electricity markets in jurisdictions overseas that could provide insight into the development of options to address issues raised in the rule change request?**

SACOSS is open to the option canvassed by the ACCC in 2002 to “*only allow rebidding that has the effect of depressing spot prices.*” SACOSS is of the view that this could be an element combined with other measures as opposed to being considered a stand-alone response to the issues raised.

SACOSS also encourages the Commission to further explore options regarding time restrictions on rebidding. We note the ACCC's past views on a three trading interval (i.e. 1.5 hours) when considered in 2002 but, considering the use of such measures in other markets (Consultation Paper p26), we consider that an interval of around 1 trading interval (ie 0.5 hours) should be considered. We are of the view that this represents a reasonable window for Demand Side Response – something for which there is much more capability and capacity in 2014 than was the case in 2002.

SACOSS also strongly supports the rule change proposal's provisions for considering the importance of generation *portfolios* rather than individual units as is presently the case (Rule Change Proposal p6, Consultation Paper p8). This, alongside vertical integration, is an example of the changed market dynamics since the ACCC's considerations of 2002. For example, given that many generation portfolios include both wind and relatively flexible gas or distillate-fired plant, there appears to be an opportunity for wind farm output to be marginally and/or temporarily curtailed to influence the accuracy of pre-dispatch forecasting

and therefore create an environment ripe for late, strategic rebidding to the benefit of the balance of the portfolio. SACOSS is not aware of any specific instance of this occurring but is alert to the possibility.

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In conclusion, SACOSS notes that the Consultation Paper states (p22):

*“Ultimately, the ACCC determined to allow rebidding with a condition of market monitoring that would assess the impact of rebidding activity on spot market price outcomes<sup>10</sup>. The ACCC’s determination obliged NECA to monitor variations in prices and prepare quarterly reports for the ACCC and the public that identified and reviewed any significant price variations. The ACCC considered that the information accumulated through the market monitoring process would drive possible market reforms into the future.”*

Reflecting on the numerous rule change proposals and Ministerial Council considerations on the issues in the years since the ACCC’s determination, it is clear to SACOSS that there has been more than enough ‘market monitoring’ to initiate some concrete action.

Further, the Consultation Paper notes that AEMO publishes the timing and reasons for all rebids (p3). However, SACOSS is disappointed that the Consultation Paper does not present any analysis of the timing of rebids in the dispatch/trading interval cycles. We note that some analysis was presented by a consumer represented (VISY) at the stakeholder forum held by the AEMC for this rule change.

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<sup>10</sup> ACCC, *Amendments to the National Electricity Code – Changes to bidding and rebidding rules*, 4 December 2002, pp. 5-6.