Macquarie Generation

23 May 2014

John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Pierce

BIDDING IN GOOD FAITH

Macquarie Generation welcomes the opportunity to comment on the South Australian Energy Minister's Rule change proposal, *Bidding in Good Faith Rule 2014,* as detailed in the AEMC's Consultation Paper, 10 April 2014.

Macquarie Generation opposes the proposed amendments and additions to the good faith rebidding provisions. We consider that the Rule change goes way beyond any clarification of the original intent of the current rebidding Rule. It effectively means that all rebids are made in bad faith unless a generator can prove otherwise to the regulator, would add substantial compliance costs and liability risks for all generators and spot traders, and ignores the issue of relevance or the materiality of any perceived problem.

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The attached submission covers the following specific matters:

1. Burden of proof and admissibility of evidence
2. Rebidding "as soon as practicable"
3. Costs of complying with the *de-facto* burden of proof on generators
4. Late rebidding of fast start plant that lowers the spot price
5. Moderating the incentives created by the '5/30 anomaly'

Macquarie Generation endorses the commentary and analysis detailed in the National Generators Forum submission to this Rule change process.

Yours sincerely

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**MACQUARIE GENERATION SUBMISSION – GOOD FAITH BIDDING**

Rebidding is an integral part of the NEM design. Rebidding allows generators to respond throughout the trading day to new information on demand conditions, changes to the transmission network configuration, adjust output levels as plant conditions vary and react to the bidding behaviour of competitors. In our view, the rebidding process is overwhelmingly positive in delivering efficient price outcomes.

Macquarie Generation places utmost importance on complying with the "good faith" rebidding provisions in the Rules. We have developed systems for processing and documenting rebids, have established internal protocols for triggering a rebid, and regularly train our trading staff on compliance requirements. We only ever rebid if we have a genuine intent to honour that bid at the time it was made.

Macquarie Generation does not support the proposed changes to the rebidding provisions. We consider that the proposed rewriting of the Rules goes way beyond any clarification of the intent of the current Rules to address the unique set of circumstances that were considered in the Federal Court's AER vs Stanwell decision of 2011. The proposed changes include fundamental alterations as to how the good faith provisions could be monitored and enforced, and would dramatically increase compliance costs and liability risks for all generators. We do not consider that the proponents have established the case for such far-reaching changes.



In addition to these issues, the following submission proposes one possible change to dispatch and settlement arrangements that may more directly target the underlying cause of some late rebidding activity.

1. ***Burden of proof and the admissibility of evidence***

Under current arrangements, generators are required to provide a brief, verifiable and specific reason for every rebid. In addition, the AER has the power under section 28 of the NEL to compel generators to provide the AER with whatever information it needs to assess and enforce compliance with any provision of the NEL.

Under the proposed changes to the good faith provisions (the amended clause 3.8.22A(b)), a trader shall be deemed to have made a rebid that is *not* in good faith *unless* there was a genuine intent to honour the rebid. In combination with the requirement to provide "complete data" to the AER (the proposed clause 3.8.22A(d)), a trader would in the future be required to demonstrate a genuine intent to honour the rebid by actively furnishing evidence to the AER proving that the rebid was made in good faith. By default, if such evidence is not *"completely"* furnished or if such an evidentiary hurdle is not met, then the trader is by default, guilty of acting in bad faith irrespective of the truth of the matter.

The legal system usually does not place this hurdle upon the defendant. Where a reversal in the burden of proof occurs, it is usually in minor matters like summary offences, like parking tickets and littering, where the penalties are relatively minor and merely administrative from a judicial viewpoint.

In the case of rebidding, traders face a personal civil penalty of $1 million for breaches of the rebidding provisions. Macquarie Generation is not aware of a proper and comparable legal circumstance that justifies attaching such a large penalty to an infringement that reverses the burden of proof upon a party. The practical implication of this amendment is that companies will find it difficult to employ and retain staff to submit rebids if every rebid is *prima facie* not made in good faith.

In addition, the amendment opens the door for the possibility of a heavy-handed prosecutorial stance by the AER that can place an onerous evidentiary burden on any defending party. There would be nothing to stop the AER launching multiple investigations into any number of bids and rebids by various generators and their spot trading staff. The AER could decide to take court action as soon as it had a weak and incomplete response from a generator that does not thoroughly satisfy the good faith provisions. That generator and its spot traders could no longer rely on additional material that was not readily available or adequately documented in the response to the initial AER information request and investigation.

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Alternatively, each investigation could proceed over an extended period of time, which means the trader is now subject to an unreasonably lengthy period of contingent liabilities.

From our reading of the Rule change proposal, there seems to be no requirement for the regulator to demonstrate *"just cause"* in launching an investigation. In other words, there are no checks and balances to ensure that the investigative power, which places a *de-facto* burden of guilt on the generator and spot trading staff at the initiation stage, is used appropriately.

To give an extreme example of what an inequitable approach this represents, if there was a devastating loss of corporate records held by the trading team, then technically all rebids made prior to the accident will not be made in good faith simply because the evidentiary hurdle cannot be met and hence innocence cannot be proven.

In our view, the proposed Rule change, by taking away the right that a defendant has to provide additional evidence in court, constitutes a violation of natural justice for any generator subject to AER prosecution. There is no reasonable basis to exclude relevant evidence especially if it is able to exonerate a party. The right to admit and ascertain the veracity of evidence lies within the expert domain of the courts. To deny the courts the power to admit or to consider the admissibility of evidence is to usurp their traditional

constitutional role. The only outcome of this will be to bias the court's judgement, prejudice the case and deny the defendant the right to a fair hearing.

On a related matter, the proposed Rule change deletes reference to "conditions" in clause 3.8.22A(b), meaning that generators could only rebid on the basis of "material circumstances". The Rule change proposal does not justify this deletion, other than saying that "conditions" may be potentially unclear. The proposed Rule includes a number of amendments of this type that seek to limit the scope for rebidding by making it harder for generators to provide evidence to substantiate rebidding decisions. This change is not supported.

### 2. Rebidding "as soon as practicable"

Macquarie Generation questions the workability of the proposed requirement to make every rebid "as soon as practicable" after the occurrence of a rebid reason.

Macquarie Generation agrees with the South Australian Minister that generators should not rebid on the basis of changes that happened much earlier, of which by itself, is not a reasonable trigger for a late rebid. However, working life in a trading room is never that simple. In many cases, rebids are the result of a combination or the accumulation of multiple events, some of which may have occurred earlier. They are often not attributable to a single condition or circumstance.

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An example of a rebid with multiple reasons could include a generation unit trip by a competitor or a transmission element outage early in the trading day. AEMO data may indicate that the unit or transmission element is expected to return to service later that day. As the day progresses, AEMO pre-dispatch demand forecasts for that evening may be higher or lower than earlier forecasts and competitors may be responding to the demand changes. If a trader observes that the generator unit or transmission network element return to service is delayed until the next day, combined with the changes to the AEMO forecasts for demand and any other number of observed or perceived changes, there may be multiple incremental reasons for the rebid.

In this example, none of the changes by themselves may be sufficiently significant, but when considered in totality, we may consider they would justify a rebid. The AEMC's Consultation Paper recognizes that it takes time for a spot trader to identify changes in market conditions, to consider a response and to execute the rebid. In addition the AEMC appreciate that a rebid may occur after a sequence of events. We agree with the AEMC's assessment in this area.

Macquarie Generation is of the view that the South Australian Minister's proposed changes would not provide any clarity on when a rebid should be lodged, or provide any

improvement on the current requirements set out in the AER's Rebidding and Technical Parameters Guideline. We do not support the proposed drafting.

### 3. *Cost of complying with the de-facto burden of proof on generators*

Rewriting the Rules to impose a *de-facto* burden on generators to prove to the AER that every rebid was not made in bad faith will dramatically increase the compliance costs of generators. While Macquarie Generation has excellent systems for recording the reason for each and every rebid, preparing a defence in each case to meet any hurdle set by the AER would take time and resources. Larger generators make dozens of rebids every day, which can then multiply on particularly busy days – for example, when plant conditions are unstable, peak demand diverges from forecasts, or network constraints are affecting generator dispatch.

The proposed Rule inserts new text requiring generators to provide a brief, verifiable and specific *statement of the* reason(s) for the rebid. Separately, but at the same time, the AER has requested that AEMO initiate changes to expand the "rebid and reoffer" field in its electricity market management system from 64 characters to 300 characters. Macquarie Generation does not consider that it is practical to set out a requirement for generators to provide a "statement" of the reasons for each and every rebid. This is just not achievable during busy periods when spot traders are observing and responding to multiple changes to market circumstances and conditions. This is why we have trader's logs, so they can make contemporaneous notes documenting key changes throughout a trading day.

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Rewriting the good faith provisions so that generators have to prepare their defence against questions from the prosecutor rather than at a later time in court, also raises the related question of procedural fairness for generators and trading staff. Having to examine all market data, trading strategies, log books, phone records and other material can take much time for trading staff to assemble and document, which may not be possible to complete fully or thoroughly in the time frame set by the AER. Despite best endeavours and the best systems, it simply may not be possible to comply with a detailed investigation in the timeframes imposed.

### 4. *Late rebidding by fast start plant that lowers spot prices*

Since the rebidding provisions were included in the Rules over a decade ago, Macquarie Generator has never observed or been aware of any regulatory scrutiny of fast start plant that rebids capacity in higher priced bands to lower priced bands at late notice in response to higher prices, even in circumstances where the higher price has failed to reach the original offer price of the fast start plant. Apart from providing market data, the AER's weekly trading report focuses on price events above $300/MWh. The AER's $5,000 reports usually involve a forensic review of how individual generators

contributed to the particular event. The AER never reports on instances where fast start plant reacts to higher pre-dispatch prices, crashing the spot price following rebids within a trading interval – often displacing low cost plant with higher cost plant in the dispatch process. Spot traders take a cynical view that rebids that lower spot prices are ignored by the AER as they are somehow an intrinsically "good rebid", and the question of good faith and genuine intent is not a regulatory risk in these circumstances. Macquarie Generation's view is that selecting rebids for further analysis should not be based on the impact of the rebid on pricing outcomes.

**5. Moderating the incentives created by the 5/30 anomaly**

The South Australian Rule change proposal focuses heavily on bidding close to dispatch, including within the trading interval, which may preclude a competitive response from both generators and larger loads. Macquarie Generation agrees with the AEMC that the design of the NEM bidding process and trading arrangements – namely, 5-minute dispatch and 30-minute settlement – may be a contributing factor to the underlying issue that the Rule change purports to address.

The '5/30 anomaly' can provide a financial incentive for participants to consider two types of bidding behaviour:

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1. If there is a price spike or high prices at the start of a trading interval, fast start plant has an incentive to quickly rebid volumes into lower price bands, be dispatched by AEMO, and earn the average spot price for their average dispatch output across the six dispatch intervals. A temporary spike in demand that occurs early in a settlement period may result in a spike in spot prices. Under current arrangements, fast start plant operators may earn a share of this high dispatch interval price even though they did not contribute capacity or energy during those earlier dispatch intervals that mattered the most.

2. Generators with fast ramp down capability that are being dispatched may have an incentive to rebid and spike the 5-minute price towards the end of the trading interval to push up the 30-minute average price for all their average output in that half-hour. Fast start plant may be unable to react in time to take advantage of the price spike and displace the higher-priced plant. Similarly, larger loads with some form of spot exposure may not be able to curtail their consumption towards the end of the trading interval.

As noted by the AEMC, NEMMCO conducted a study that examined a number of options to address the '5/30 anomaly' in 2002, although its assessment concluded that there "was not a compelling case to show that the efficiency benefits would outweigh the costs

of implementing the nominated options".[1] This was primarily associated with the high cost of installing replacement meters in the NEM to measure output on a 5-minute basis.

One approach that was not considered by NEMMCO or industry in 2002 was the option of 5-minute dispatch and 15-minute settlement. Macquarie Generation understands that all, or the vast majority of, NEM metering for both generating units and individually metered loads, is recorded and collected on a 15-minute basis. AEMO processes the 30-minute settlement by aggregating the two 15-minute meter readings.

Moving to 5-minute dispatch and 15-minute settlement would not completely remove the rebidding incentives created by simple time-weighted price averaging over a period of dispatch intervals, but it would moderate the impact by halving the number of dispatch intervals in a settlement period. If it takes a fast start plant 10 to 15 minutes to synchronise, they would not have time to rebid late to take advantage of price averaging over the 3 dispatch intervals, including those instances where fast start plant did not contribute energy or capacity in response to an earlier temporary spike in demand during the trading interval. Similarly, dispatched generators would accrue smaller benefits from any price volatility in a settlement period with 3 dispatch intervals.

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Macquarie Generation is not suggesting that the '5/15 approach' would necessarily pass a cost-benefit analysis if changes in this area were reconsidered today. We do however consider that such an option may offer a workable if not exact solution and would be superior to a fundamental rewriting and recasting of the good faith provisions as proposed by the South Australian Minister.

**Summary**

The proposed Rule changes are likely to result in more conservative rebidding behaviour by generators. The AEMC needs to weigh up the case of making it easier for the AER to prosecute generators against the efficiency benefits of a more flexible supply side response to new market information throughout the course of the trading day, including the signals this sends to new investors in the NEM.

[1] NEMMCO, Final Report, 5/30 Issue, February 2003, p.3.