



BIDDING IN GOOD FAITH RESPONSE TO DRAFT DETERMINATION

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1 Executive Summary

Stanwell welcomes the chance to respond to the Australian Energy Market Commission's (Commission or AEMC) draft determination on the bidding in good faith rule change request.

The draft rule appears primarily intended to clarify that generators must not deliberately delay entering a rebid until very close to dispatch in order to reduce competitive response. The AEMC are concerned that if such activity were to take place and result in inefficiently high pool prices, this could lead to inefficient investment in peaking generation which would not be in the long term interest of consumers.

Stanwell strongly supports improvements to ensure that information presented to the market is robust and timely, assuming such improvements do not create more problems than they solve. There are elements of the proposed rule change which appear rational and beneficial in achieving this goal, however other elements appear to mischaracterise the problem and are likely to impede, rather than improve, market efficiency.

By allowing the Australian Energy Regulator (AER) the ability to set the parameters for the proposed late rebidding reports, the draft determination circumvents NEM governance principles. The action effectively delegates rule making to the body (AER) which is tasked with rule enforcement. While guidelines may assist the market, an approach which sees the AER making what are, in effect, rules, flies in the face of the governance arrangements which underpinned the creation of the AEMC and the AER and should be avoided.

The draft rule also contains elements which appear to require a court to consider bids as false or misleading if a rebid occurs during or immediately prior to the trading interval¹. This would occur regardless of the reason for the rebid or the time at which the change in conditions occurred. This element of the draft rule is inappropriate and should be removed completely regardless of what other changes are made.

The draft rule imposes administrative burden on all rebids entered close to dispatch in an attempt to improve long term investment signals. The Commission identifies the risk that "bad" high prices may cause inefficient future investment in generation capacity². This is despite observed high prices being strongly correlated with demand and/or network constraints and remaining well below investment thresholds.

The draft rule also claims this administrative burden to be in the long term interest of consumers despite significant components being undefined. There appears no strong justification to impose undefined administrative burden for an extended period until some potential future investment decision may be required. It appears much more likely that the rule change will result in increased costs to consumers as all generators attempt to recover the additional regulatory burden. The regulator already has significant information gathering powers and these are regularly used.

This creates an environment where the cost of the proposed rule change is unknown but potentially significant, and the benefit of the proposed rule change is unknown but likely to be negligible. Stanwell do not agree that such a change conforms to the National Electricity Objective (NEO).

The draft rule contains a new requirement that rebids be entered as soon as reasonably practical, in order to ensure that offers do not become misleading through deliberate inaction. While Stanwell supports this concept we are concerned that the proposed

¹ Draft rule change, clause 3.8.22A(e)(2). See section 3.2 for additional detail.

² Draft determination, page 25-26

implementation may have significant unintended consequences. We consider that this change can and should be made in isolation from the other major elements of the draft rule.

The draft rule requires that good faith (or replacement) conditions apply to all rebids, removing the existing limitation to rebids affecting available capacity and daily energy constraints. Stanwell supports this change.

The draft rule also allows intention to be inferred from patterns of behaviour. Stanwell do not believe that the current rules preclude such inference. Additionally, there are an abundance of rational reasons for a pattern of rebids which occur close to dispatch. These bids may occur without either the original bid or the rebid being misleading, lacking genuine intent or being inappropriately delayed.

The draft rule clarifies that the intention behind a rebid may be inferred with reference to the bidding pattern at other units controlled by the rebidding entity. Stanwell do not believe that the current rules preclude such inference.

The draft rule replaces the obligation to bid in good faith with an obligation not to enter false or misleading bids. Subject to minor alteration³, Stanwell considers that the proposed change is neither beneficial nor detrimental to market efficiency. In the absence of these alterations the draft determination appears to create an environment which puts generators in technical breach often, regardless of intent. Given the implications of this obligation are the same as the current Good Faith clause, Stanwell sees no compelling case for change.

The process of this rule change has also raised some concerns. The AEMC have released a draft more preferable rule change which is a significant departure from the original rule change request. The emergence of some elements of the rule so late in the process creates an environment of limited consultation which we believe gives rise to an inappropriate risk of unidentified and unintended consequences.

Given this limited consultation and a lack of clear cost/benefit analysis, the Commission should refrain from making the contentious elements of the draft rule change determination.

³ Explicit provision of a safeharbour for honest and reasonable mistakes, clarification of evidentiary burden on Market Participants.

2 Background

2.1 Operation of existing law

The current provisions in the National Electricity Rules (NER) require that generators make all bids and rebids in good faith. At the time of making the bid, the generator must have a genuine intention to honour that bid if the material conditions and circumstances upon which the bid is based remain unchanged.

In 2011 the Federal Court handed down judgement finding Stanwell not guilty of alleged breaches of the good faith bidding provisions (*Stanwell*). The proponent considers that the Federal court determination is inconsistent with Ministers' intent when introducing the good faith provisions to the National Electricity Code in 2002⁴.

The AER now acknowledge that prior to *Stanwell* they believed that a "change in material conditions" was limited to objectively observable changes, that is, excluding subjective expectations⁵. This artificially limited view of the strategy formation process has been confirmed as incorrect both by the Federal court and experts in price formulation⁶.

The acceptance that subjective expectation is a critical input to all rebidding would significantly change the rationale underlying the rule change request. This is clear from the fact that the request explicitly aims to exclude subjective expectation from the list of reasons that good faith rebids may be made.

Further, were subjective expectation - and the fulfilment or otherwise of such expectation - accepted as a material change in conditions or circumstances, it appears unlikely that *Stanwell* would have occurred.

Regardless of whether the case would or should have occurred, the proponent, AER and AEMC have all indicated in public forums that the court case showed the current rules to be "unenforceable" as they require the regulator to prove a positive intent not to honour a bid at the time it was made. However the judgement in *Stanwell* makes it clear that the contemporaneous records, supported by subsequent information provision and testimony, reflect situations where it was likely that the trader had a genuine intention to honour the bids at the time they were made. That is, on the balance of probabilities it is reasonable to conclude that the bids were made in good faith.

The AEMC have largely moved away from the original rule change proposal, with the draft determination focussing on addressing "late rebidding".

2.2 Defining "late rebidding"

The draft determination attempts to address the risk that a generator may form an intention to rebid, but delay the action of rebidding. The Commission considers that such actions may result in the market being misled as to the intention of the generator between the formation of the intent to rebid and the actual rebid.

Further, where the delay in rebidding means that the bid is presented to the market close to dispatch it may limit competitive response which in turn may prevent the market reaching an efficient equilibrium. Where such behaviour is part of a strategy that is aimed at misleading

⁴ "The South Australian Government considers that the Federal Court decision has introduced uncertainty around the operation of the bidding in good faith provisions and highlighted issues in relation to the implementation of policy intent". Rule Change Request page 2.

⁵ AER representative at AEMC public forum, 18 May 2015.

⁶ *Bidding in Energy-only wholesale electricity markets*, Yarrow & Decker, November 2014]

competitors and promoting false expectations it can degrade the reliability of information that is made available to market participants and erode confidence in the market design.

Where such inefficiency could exist in the short term and result in high prices⁷, the Commission appear concerned that excessive future investment in generation stock or demand response capability may occur and that this inefficient investment would not be in the long term interest of consumers.

While the term “late rebidding” or “late strategic rebidding” has been used by the Commission throughout the rules change process its meaning appears to have changed materially leading to a mischaracterisation of market behaviour. Much of the stakeholder engagement, including the ROAM Consulting quantitative analysis has focussed on rebidding which occurs close to dispatch regardless of the reason for the rebid. The draft determination reflects this focus by applying a blanket reporting requirement to rebids occurring within 15-40 minutes prior to the start of the dispatch interval. There has been no analysis to indicate that any generator has misled the market by delaying a rebid (once a decision to rebid has been made).

The terms “late rebidding” and “late strategic rebidding” falsely imply impropriety on behalf of generators. It does not distinguish between those who enter rebids close to dispatch relating to a recent change in conditions and those who enter rebids close to dispatch despite having formed an intention to rebid at a much earlier time. Stanwell believe that the distinction between these events is significant and should be reflected in more appropriate, tightly controlled use of the terminology. At the AEMC public Forum in May we suggested the term “delayed rebidding” as a way to differentiate the inappropriate activity from legitimate rebidding close to dispatch.

While not particularly relevant to the original rule change request, in considering “late rebidding” it is notable that the bidding activity impugned in *Stanwell* were instances of rebids placed relatively close together⁸ in response to evolving market information. Such activity does not appear to fall within the AEMC’s characterisation of concerning conduct for this rule change, bringing into question whether the draft determination has “regard to the relevant issues in the rule change request”.

2.3 Efficiency of “high” prices

During the rule change process, consistent references have been made to the appropriateness or otherwise of observed volatility in prices, particularly in Queensland in recent years and to a lesser extent South Australia. The draft determination attempts to address this through statements such as

“The Commission acknowledges the general consensus among stakeholders that a change in generator ownership in Queensland has had a role to play in recent instances of late rebidding”⁹.

In the Options Paper, the Commission noted that it would need to carefully consider any regulatory response which applied to all participants in the NEM to address an inefficiency that may be largely a product of conditions specific to certain regions.”¹⁰

⁷ Draft determination page 25. Almost all other references to price are to “efficiency”, however this confirms that the focus of efforts to reform market rules relate to high prices.

⁸ In each instance a bid was impugned by the presence of a rebid less than 20 minutes later.

⁹ “late rebidding” in this context appears to mean all rebidding which occurs close to dispatch.

¹⁰ Draft determination, page 26

Both the stakeholder comments and the Commission's response appear to ignore the reality that the vast majority of high price events in Queensland in recent years have been related to one or both of high demand or network congestion.

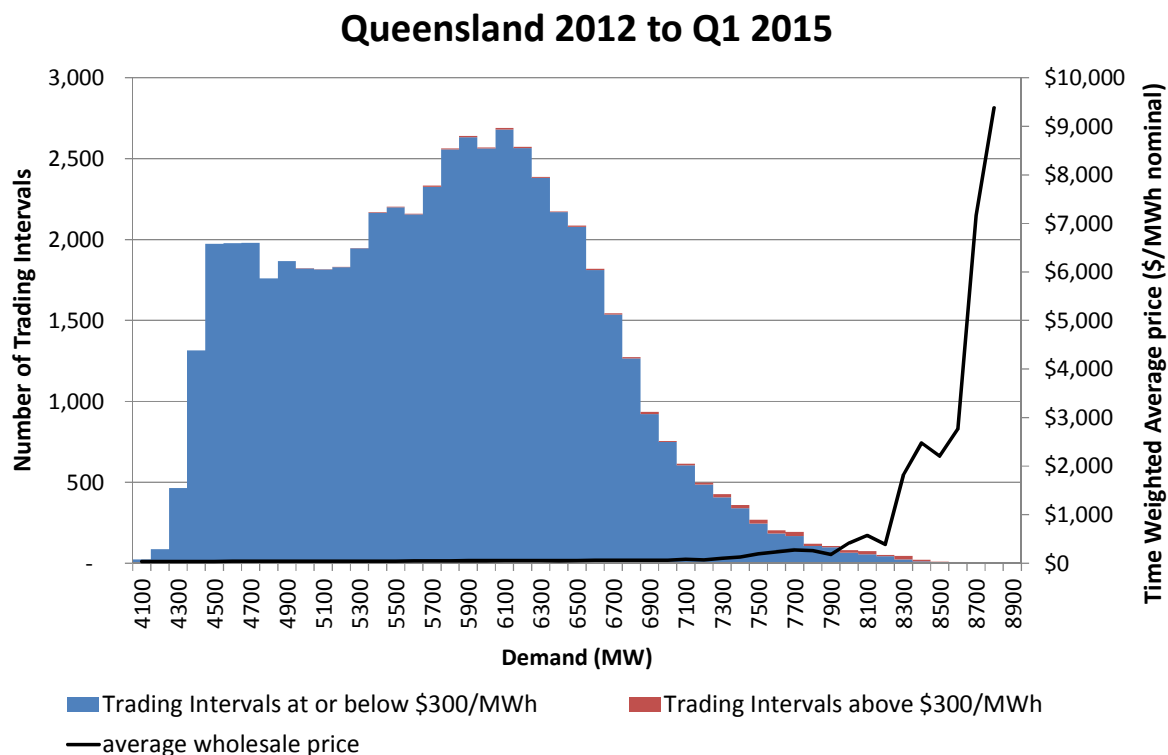
Analysis of generation patterns from (relatively) high cost peaking generators confirms that most plant was operating for most of these events¹¹. While demand side participation information is opaque, commentary contained in the AER price event reports indicates that significant demand reduction had occurred leading up to the high price periods. These reports also indicate that high prices were often not predicted for these periods significantly ahead of time¹², indicating that dispatch decisions of both generators and demand response are being made based on inputs other than the pre-dispatch price schedule.

Additionally, NEMDE is specifically designed to determine prices which are reflective of supply and demand over the relevant period. Accordingly, claims that prices are not reflective of underlying supply and demand conditions appear false or misleading.

Price as a reflection of demand

There is a strong observable correlation between demand and price in Queensland in the absence of significant network constraints. Further, with the exception of network constraints (dealt with below), the overwhelming majority of high prices can be seen to have occurred at times which would be expected. For Queensland, the majority of high prices occur in the top 5% of demand - essentially the daylight hours to early evening during hot Summer days.

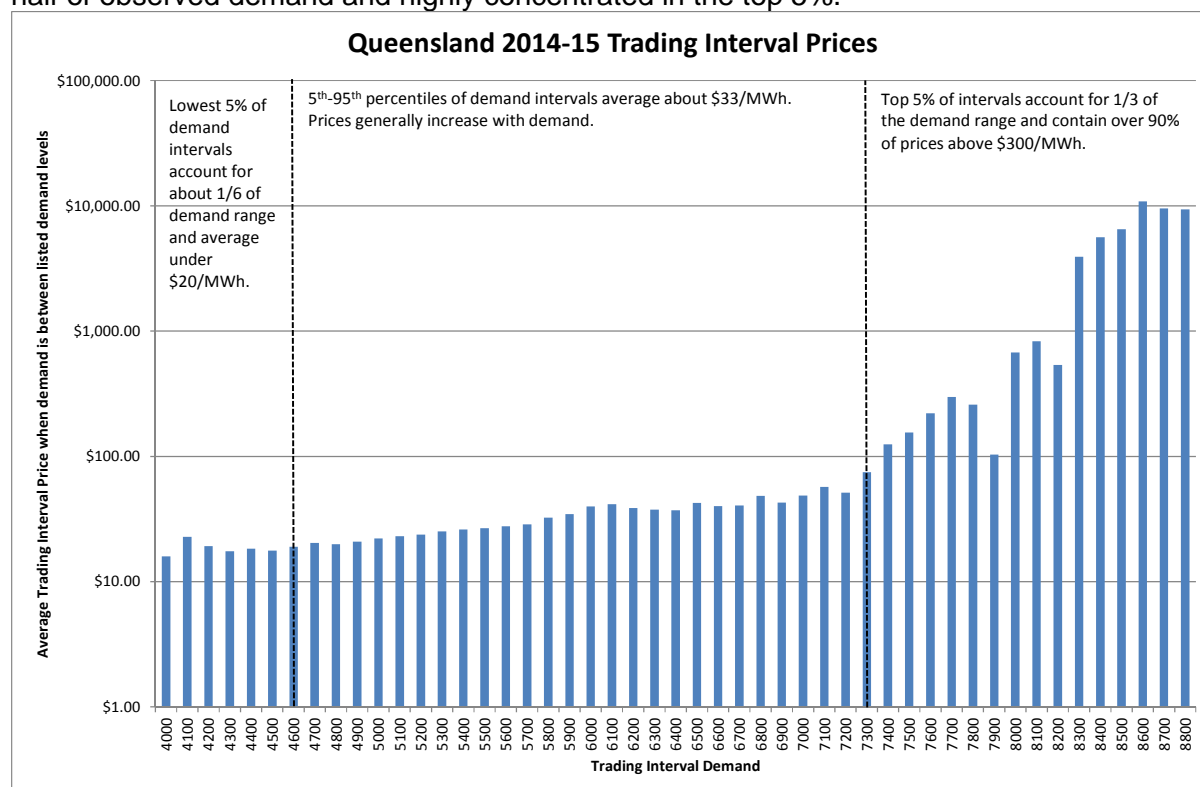
The chart below shows that between January 2012 and March 2015, Queensland demand has typically been between about 4500MW and 7000MW with only occasional excursions outside this range. Over 2/3 of prices above \$300/MWh have occurred during the <7% of periods above 7000MW.



¹¹ See Stanwell response to options paper.

¹² AER analysis focusses on forecasts published 12 and 4 hours ahead of the event.

Similarly, prices in 2014/15 to date have exhibited an extremely strong correlation with demand as shown below. Prices above \$300/MWh are completely absent from the lower half of observed demand and highly concentrated in the top 5%.



While pre-dispatch forecasts of demand are imperfect they are typically much less volatile than other inputs such as network performance, generator availability or rebidding. Accordingly, a low capacity factor plant (or demand response) operating based on demand rather than solely price forecasts would have benefitted from the majority of high price events in recent years. There appears no basis to the claims that the majority of observed high prices are inappropriate, inefficient or un-forecastable.

Price as a reflection of network constraints

During periods of network constraints, regional supply/demand analysis is no longer relevant – the relevant values become the supply and demand observable from the reference node. Despite this, generalised trends may still be observable from region level data.

Significant network impacts were observed in NSW in 2009-2010, and Queensland in 2012-2013, with both periods exhibiting relatively low correlation between regional demand and price compared to the years either side. For the Queensland constraint¹³ the majority of effects occurred in the 2012/13 financial year as shown below, although the constraint was also active in early 2012 and late 2013.

Year	Number of Dispatch Intervals		
	Constraint binding	Price > \$300/MWh	Price >\$300/MWh and constraint binding
2011/12	2636	67	63
2012/13	5732	641	377
2013/14	2	118	0

¹³ Q>>NIL_855_871 and/or Q>>NIL_871_855

While network constraints and rebidding close to dispatch tend to be correlated¹⁴, in most cases the causal relationship is that the binding constraint precedes the rebidding. Particularly in relation to fully co-optimised constraints, the relationship between a rebid and the effect on the constraint in the short term is complex and can often be counter-intuitive¹⁵. Accordingly, changing rebidding rules is unlikely to have an effect on constraint related price events except by coincidence.

2.4 Timing of high prices within a trading interval – the 5/30 issue

The timing of high prices within trading intervals has recently become a focus of analysis purporting to show inefficiencies in market outcomes. The rule change request was submitted late in 2013 and referred to “recent years”, particularly with reference to South Australia and Queensland, while this “timing” analysis focusses on 2014 in Queensland¹⁶.

As indicated above, in the absence of network constraints the vast majority of volatility is relatively easily predictable – occurring during periods of very high demand – and for such events the timing of a high price within a trading interval should be largely immaterial.

Analysis of recent history shows no correlation between the relative frequency of high prices late in a trading interval and costs to consumers or short speculators (as measured through the cap payout). While 2012 and 2014 exhibited similar frequencies of high prices and relatively frequent high prices late within the trading interval, the difference between cap values is stark. By comparison 2013 exhibited relatively frequent volatility, spread relatively evenly within the trading interval with a cap outcome ten times that of 2012 but only seven tenths that of 2014. While only 5 months of data are currently available for 2015 it appears likely to provide yet another distinct relationship – or more accurately, lack of relationship.

	Number of Dispatch Intervals > \$300/MWh	% in Dispatch Interval 6	Total cap payout
2012	125	29%	\$0.79/MWh
2013	615	18%	\$7.04/MWh
2014	165	44%	\$10.36/MWh
2015*	289	23%	\$11.16/MWh

To the extent that high priced dispatch intervals were abnormally distributed towards the end of trading intervals in 2014, this appears to be a short term phenomenon which has already been counteracted through a quite minor competitive response¹⁷. Such an outcome is likely to be far more preferable for market efficiency - and therefore long term consumer interest – than onerous regulatory changes.

Much of the commentary also implies that the 5/30 design only creates negative impacts on customers through high prices occurring late in a trading interval, whereas it actually applies to all participants, all the time in relation to all prices. Peaking plant changing operation away from their previous offer (or demand side participants reducing their consumption non-

¹⁴ ROAM Consulting *Analysis of rebidding activity in the NEM*, October 2014 page 31-32 “Binding transmission constraint equations have a significant relationship with rebidding frequency in all years”

¹⁵ For example under the Q>>NIL_855_871 constraint many of the high dispatch interval prices were set by a combination of Callide being constrained off at a negative bid price and other units being constrained on at a positive bid price. A rebid which moved volume from low price to high price at Callide would therefore be likely to *decrease* rather than *increase* price.

¹⁶ Visy response to Consultation paper references 2013 and part-2014 combined Queensland data as was available at the time. ROAM Consulting report to options paper focusses on 2014 only.

¹⁷ See Stanwell response to options paper.

transparently) during a trading interval in response to an early high price produces the complementary risk for generation participants who are online or respond automatically to the high price, but is for some reason viewed as being efficient rather than distortionary. Similarly, generation plant responding to a high price early in a trading interval are subject to the risk that later dispatch intervals are much lower – even negative. An example of such risk can be found in the ROAM modelling for the 2014 Reliability settings review and is shown below.

Table 8.4 – Queensland Pool Price Outcomes – 30 August 2012

Dispatch Interval Ending	Queensland Pool Price (\$/MWh)
13:05	7249.93
13:10	-471.09
13:15	-1000
13:20	-1000
13:25	-1000
13:30	-1000

2.5 Wholesale outcomes remain consistent with the long term interest of consumers

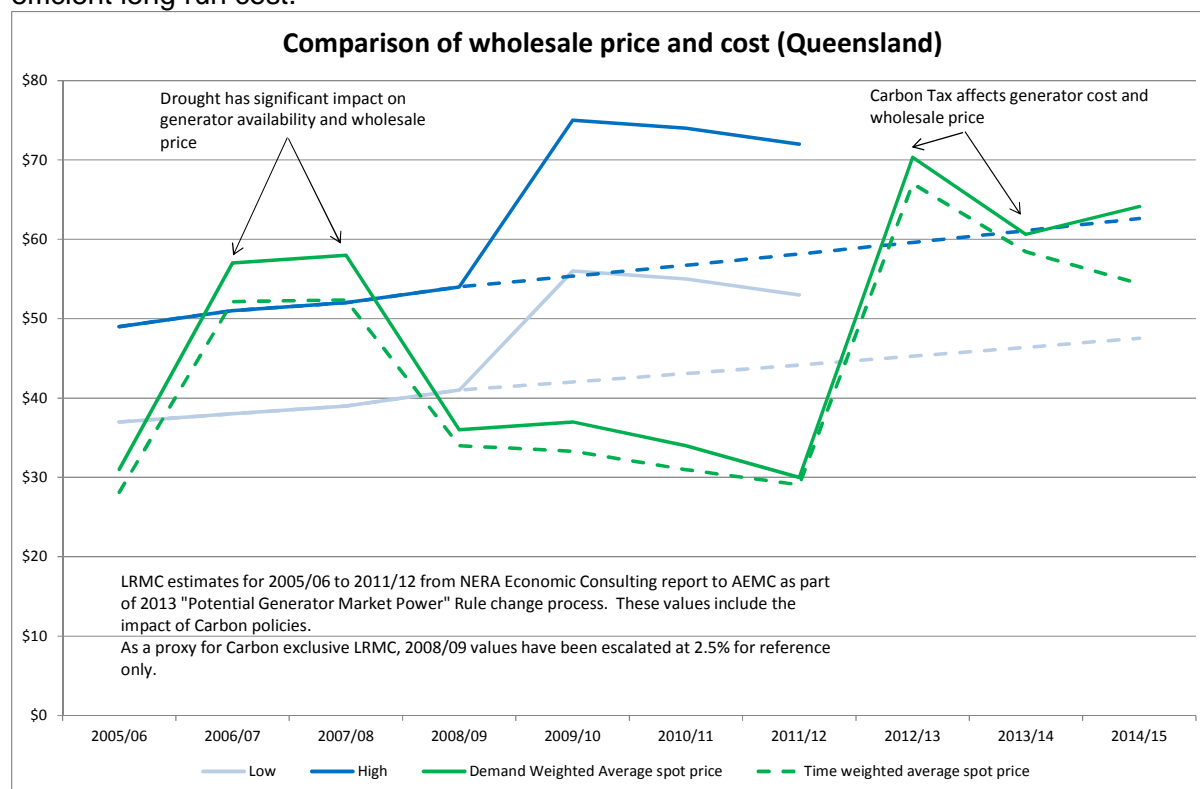
Despite significant increases in retail electricity costs in recent years, the wholesale price of electricity remains near or below the efficient cost of generation. Further reductions through regulatory changes will reinforce an unsustainable environment which is likely to be against the long term interest of consumers.

The chart below builds on the work of NERA Economic Consulting during the AEMC's 2013 rule change process relating to "Potential Generator Market Power". It provides a publicly available estimate of the Long Run Marginal Cost of generation in each NEM region – in this case Queensland is used for consistency with the rest of this submission. NERA's estimate includes the impact of the announced but not implemented early versions of the Carbon Tax which did not ultimately affect spot market outcomes¹⁸. For ease of reference Stanwell has applied a simple "cost + CPI" approximation of LRMC based on the early years of the NERA estimates (as these are unaffected by Carbon).

For the 2012/13 and 2013/14 financial years the NEM observed a step change in "normal" prices correlating to the impact of the Carbon tax on short run and long run costs. Looking through this impact, wholesale prices remain in the \$25-50/MWh range in all regions - consistent with or below publicly available estimates of Long Run Average or Long Run Marginal Cost of generation.

¹⁸ Where Carbon scheme uncertainty affected contract positions significantly there would likely be an impact on spot outcomes, however no such impact is apparent in this data.

For the 2014/15 financial year most regions observed a significant reduction in high price events, feeding into low average prices and reflecting the general deterioration in demand in those regions. The exception has been Queensland which has seen increases in both peak and average demand levels and correspondingly higher prices. These prices have overwhelmingly occurred during periods of high demand, indicating that they are broadly efficient and rational. Further, even in the relatively high priced Queensland region, 2014/15 average prices appear likely to be marginally above \$60/MWh¹⁹ – broadly in line with efficient long run cost.



Wholesale prices are at or below the long run efficient cost of generation, and price is strongly linked to demand. Such a scenario is clearly in the long term interests of consumers.

Additionally, financial hedges remain available at sustainable levels - both for standard and bespoke arrangements – allowing customers and retailers to manage risk if they choose to do so. Stanwell is also aware of arrangements for the management of both prudential exposures and demand response risk where such exposures are of concern, although these issues lay outside the current rule change process.

2.6 Investors are responsible for their investment trade-offs

The draft determination identifies the risk to consumers of inefficient investment in the long term driven by inefficiently high short term pricing. This appears contrary to the growing body of evidence that wholesale prices are below efficient levels in most regions, most of the time.

Any potential new entrant to the NEM will determine the viability of their investment based on a large number of factors including location, technology, fuel availability, as well as forecast demand, price and environmental considerations. Every investment decision will result in

¹⁹ Demand weighted. Time weighted average appears likely to be slightly in excess of \$50/MWh. Estimates based on AEMO data to 30 May 2015 and ASX June monthly contract at COB 30 May.

trade-offs – for example more flexibility or faster response time generally comes at higher cost – and it is for the investor to identify and weigh these costs for their specific risk appetite. Accordingly it is unlikely that a new entrant would simply invest based on historical cap or high price outcomes without considering the “capturable” revenue for their specific investment proposal.

The most recent AEMO Statement of Opportunities was notable primarily for their lack – no market or reliability driven new entry was forecast for at least 10 years other than RET subsidised projects. Similarly, the 2014 review of NEM reliability settings by the Reliability Panel found that a peaking plant would require cap payouts in the order of \$11/MWh to be sustained over 20 years to warrant entry²⁰. This is greater than ALL of the high prices observed during any recent Calendar year in Queensland. The proportion of this value which could be ascribed to “delayed rebidding” and therefore potentially be addressed by the draft determination appears extremely small.

However if an investment were to be made and ultimately be unable to recover sufficient revenue it would be the investors (and their financiers) who would suffer, rather than consumers. Unlike overinvestment in regulated monopoly businesses, generators are not guaranteed a return.

²⁰ <http://www.aemc.gov.au/Markets-Reviews-Advice/Reliability-Standard-and-Settings-Review-2014>
ROAM final report, Appendix Table E1, ~\$100,000/MW/annum capitalised cost for OCGT, divided by 8760 hours per year implies \$11.42/MWh

3 Behavioural statement for generator bidding

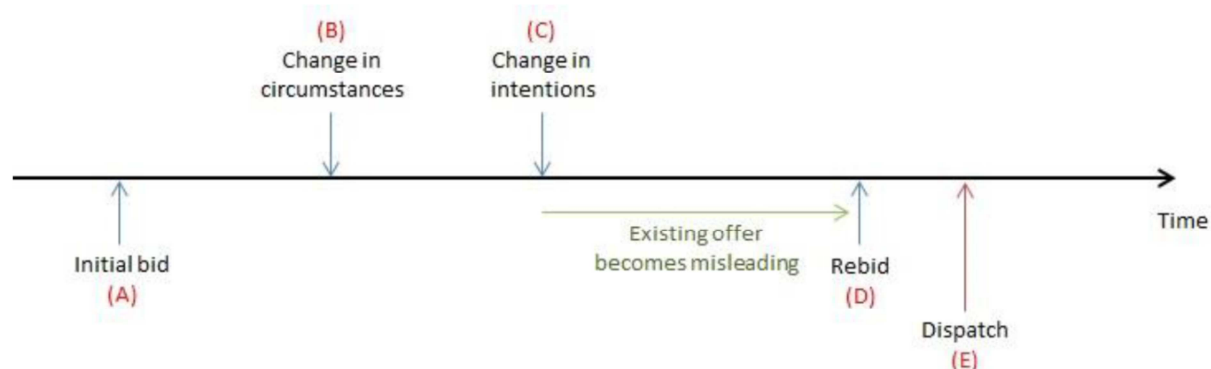
Stanwell has previously stated that it would consider whether alternative behavioural statements exist which would improve on the current rules, and does so in the following section.

3.1 New requirement for rebids to be made as soon as reasonably practical (clause 3.8.22A(d))

Stanwell supports efforts to ensure that information provided to the market is reasonably reflective of the intended actions of participants. Accordingly we support the concept that rebids should be made as soon as reasonably practicable, but are wary that the implementation of such a requirement may have unintended adverse consequences.

Determination of what is “reasonable” by the regulator and ultimately the court will become critical to the enforcement of the rule. This may be complicated by the Commission’s intent that any “delay” in rebidding be a measurement between a non-observable event and an observable one.

Figure 4.1 A misleading dispatch offer



Under current rules, when making a rebid (at time D) generators are encouraged to refer to the time of the change in material conditions or circumstances (B). As correctly represented by the AEMC, the timing of (B) relative to (D) can appear inappropriately long depending on when the intent to rebid is formed (C).

As long as the rebid occurs reasonably soon after the change in intention, and is made with a genuine intention to honour it, there should be no concern that the market is being misled. However measuring (C) is likely to be more difficult and subjective than measuring (B) or (D). Such uncertainty may become material where the trader is subject to competing demands on their time – for example on a high demand afternoon where data is volatile. In such circumstances the trader is likely to prioritise analysis of the nearest period first, potentially creating a significant gap between the change in circumstances (B) and the formation of an intent to rebid (C) even as the time between the rebid (D) and dispatch (E) becomes limited.

Similarly, multiple parties may respond to a change in circumstances (B) in different timeframes – whether due to competing priorities, lower staffing, more complicated decision making or any number of other causes. It would be inappropriate for the slowest respondent referencing a particular change in market conditions was considered “unreasonable” on the basis that competitors were able to respond faster.

As discussed in the following section, the time between a rebid (D) and the dispatch interval to which it first applies (E) is not directly related to whether the trader had a genuine intent to honour the preceding bid (A) or the rebid (D).

3.2 New requirement for rebids to explicitly allow time for competitive response (clause 3.8.22A(e))

The Commission have proposed to include a requirement that a court must have regard to:

“whether the rebid was made in sufficient time to allow reasonable opportunity for other Market Participants to respond (including by making responsive rebids, by bringing one or more generating units into operation or increasing or decreasing the loading level of any generating units, or by adjusting the loading level of any load) prior to

- (i) The commencement of the trading interval to which the rebid relates; or*
- (ii) The commencement of any dispatch interval within the trading interval.”*

Such a requirement is illogical, impractical and misguided and should be removed before the final determination.

At the public forum on May 18, the Commission indicated that this clause was not meant to apply to trader decision making, but to guide the court in interpreting the clause. This is a highly unorthodox approach to drafting a law. The proposition that a market participant, deciding whether its desired action is allowable, can disregard a provision that is intended to guide a court in determining whether the market participant has broken that law is extraordinary. Clearly any prudent market participant will consider all provisions of a law in assessing their own compliance. Not to do so would be reckless.

There is simply no logical nexus between the substantive requirement (ie. make a rebid as soon as reasonably practicable) and the so-called guidance provision (ie. assess compliance by reference to the time between the making of the rebid and the commencement of the affected interval). The test for compliance must depend on the time that passes between the time the change in circumstances (B) or intention (C) and the time of the rebid (D), and the reasons for that period of time.

Such a rule may require the trader at one generator to make significant assumptions about the responsiveness of all competing generators before making a rebid, and create differential application of the rules. For example, if all available generators in a region were online except one, and that generator typically had an offered fast start profile which indicates over 20 minutes to synchronise and 30 minutes to reach stable operation, traders at competing generators appear to be limited in their ability to rebid within this response time, while traders at that offline generator are not.

The construction of the clause appears to require the court to take a negative view of any rebid which occurs during the trading interval to which it applies (or during the dispatch interval immediately prior to that trading interval), since the rebid will become effective concurrent with the next publication of pre-dispatch, providing no opportunity for other Market Participants to respond to the rebid *prior to the commencement* of the next dispatch interval to which it relates.

It is also unclear how such consideration would be meaningful if the material change in market conditions (which lead to a change in intent, which lead to a rebid) occurred

immediately before the dispatch interval to which the rebid would apply. That is, in the graphic above, if (B) to (E) are separated by only a few minutes.

For each of these reasons, clause 3.8.22A(e)(2) and preferably all of clause 3.8.22A(e) should be removed before the final determination.

3.3 Applying good faith requirements to all rebids (clause 3.8.22A(a))

Stanwell supports efforts to ensure that information provided to the market is reasonably reflective of the intended actions of participants. Accordingly, the application of a consistent approach to the rebidding of all fields in the rebid file²¹ is supported.

We believe that participants already bid in a consistent Good Faith approach to all rebid fields, therefore we do not expect that the explicit statement of such a requirement will affect participants' current practices.

3.4 Replacing good faith with a prohibition on false or misleading bids (clause 3.8.22A(a))

The draft determination proposes to replace the existing requirement that generators be honest with a requirement that they not mislead. While this change is, on one view largely cosmetic, it introduces additional risks and does not appear to offer any significant benefits. For this reason Stanwell believe it is unlikely to satisfy the NEO.

Stanwell also disagree with the AEMC that such a change infers that rebids are a continuing representation of a generators' intent. The new requirements under draft clause 3.8.22A(d) appears to be the change relevant to this intent.

Representations about a future matter

The draft determination states that a bid will be taken to be false, misleading or likely to mislead if the generator does not intend to honour the rebid. The bid will also likely be considered misleading if the generator does not have a reasonable basis to represent to other market participants, through pre-dispatch schedules published by AEMO, that it will honour its bid.

As addressed in section 3.2 above, this appears to inappropriately create a technical breach for any rebid which has effect from the dispatch interval immediately following its submission because the change in generator intention cannot be "*represent(ed) to other market participants through pre-dispatch*" prior to it becoming effective.

The requirement that a generator be able to provide evidence that it has a "reasonable" basis for a particular bid may also be problematic, particularly when paired with the requirement to rebid as soon as reasonably practicable. Documentary evidence of such a basis may not exist, and the recollection of traders may fade with the passage of time, or be subject to the same disputation as under the existing law.

Initial bids in particular are typically made with very little AEMO or third party information available for reference, requiring significant internal "view taking" in their construction. Where dispatch and pre-dispatch outcomes diverge significantly from these expectations rebids are likely to occur. Determining whether the basis for such early bids is "reasonable" ex-post is likely to be fraught.

²¹ Availability, rate of change up/down, volume in each priceband, daily energy constraints etc

Further, where a generator's internal expectations diverge from AEMO predispatch forecasts a generator may not rebid initially, but where the difference remains it may cause the generator's internal expectations to change, prompting a rebid.

Such a divergence between generator expectation and AEMO pre-dispatch publications can be highlighted by Stanwell Corporation's bidding approach for 17 December 2014. Stanwell's initial bid was entered at 10:45am on 16 December with the expectation that the forecast hot weather would create a significant uplift in demand from the preceding days. The initial bid also considered the impact of the expected competitor response to such conditions. Despite significant changes in pre-dispatch forecasts, this initial bid was left unchanged until 21:16 on 17 December, after the occurrence of both the highest demand and highest price observed during 2014.

While no rebids were entered prior to the high price events, a number of pre-dispatch runs caused the strategy to be re-evaluated, identifying the possibility that if AEMO forecasts did not continue to change in the manner expected by the traders a rebid may be required. Had such a rebid occurred, it may have been difficult to provide evidence that Stanwell's initial offer was "reasonable" when it was based on expectations that were so materially different to pre-dispatch. It would also have been difficult to prove that the rebid was entered as soon as reasonably practical in response to the *lack* of change in published AEMO data (and the *actual* change in traders' expectations).

Honest and reasonable mistakes

Rebids which are currently superseded by an "error rebid" appear likely to fall foul of the requirement not to enter bids which do not reflect the trader's intent, with the superseding "error rebid" neatly making the case for the prosecution.

It would be inopportune to create a situation where a trader finds themselves conflicted as to whether to enter a correcting bid and hope the regulator doesn't pursue them for an honest mistake or allow an offer to run to dispatch which was not their intent. Either action would potentially open both the trader and corporation to significant penalty.

If the proposed change from good faith to a prohibition on misleading bids is retained in the final determination, it is critical that a safe-harbour for honest and reasonable mistakes is explicitly included in the revised rule.

3.5 Explicitly allowing consideration of portfolio bidding (clause 3.8.22A(c))

Stanwell does not consider that the current rules prohibit the consideration of portfolio activity when attempting to determine whether a rebid has been made with a genuine intention to honour it. Accordingly we have no objection to explicitly stating that such inference is allowed - where reasonable - although we do not consider it necessary.

As with all "reasonable" considerations, we note that there will be occasions where different parts of a portfolio are bid separately for valid - but potentially opaque to market - reasons and that such actions should not be unduly viewed as inappropriate.

For example in response to a recent change, Stanwell rebid units at two sites, then after a delay of approximately 15 minutes rebid units at a third site with reference to the same change in conditions. The difference in timing was due to the requirement for physical plant changes at the third site which could not be confirmed immediately. While the *intent* to rebid all three sites was formed at the same time, in response to the same change in publicly available information, the *action* of rebidding necessarily occurred at a different time as further information was required for some bids - information that was opaque to the wider market.

3.6 Inferring intention from patterns of behaviour (clause 3.8.22A(c))

The draft determination allows for the intention of a trader when making a rebid to be inferred from patterns of behaviour. The rationale for this appears to be that while a specific late or delayed rebid may be made in good faith (despite limitations on competitive response due to its timing), a systemic pattern of such rebids could be used to infer an attempt to mislead the market.

In *Stanwell*, the court referred to patterns of conduct despite there being no explicit reference in the rules. Accordingly, we consider that patterns of behaviour are already capable of being inferred and therefore we do not consider the proposed change material in and of itself.

However we note that a pattern of behaviour including rebids close to dispatch does not necessarily imply delayed rebidding or misleading conduct. For example rebidding in response to changes in demand as a result of updated solar conditions will typically occur close to dispatch, and form a pattern of behaviour, but are made in good faith. This pattern of rebids is simply a response to the more up to date expectations which emerge close to dispatch.

Similarly, we consider that inferring the intention of an individual trader by reference to the actions of other traders at the same generator, potentially over significant timeframes, creates a “false positive” risk for traders exposed to significant individual civil penalties.

The draft determination also observes that a pattern of a generator failing to honour its offers (absent a change in material conditions) may be used as the basis for demonstrating the lack of the relevant reasonable basis for making a rebid. This approach would imply that any trader or generator found guilty of breaching clause 3.8.22A would be unable to enter any future bids without putting themselves in further technical breach. This is because the existence of a breach could be used to infer a lack of reasonable basis for future representations. Such an outcome appears peculiar and unintended.

On balance, it appears more beneficial to leave the proposed change out of the final determination while allowing future courts to reference a pattern of behaviour if desired, as occurred in the *Stanwell* case.

3.7 Alteration of the market design principle (clause 3.1.4)

The draft determination amends the second market design principle to include explicit consideration of “...*providing accurate, reliable and timely forecast information to Market Participants, in order to allow for responses that reflect underlying conditions of supply and demand*”.

This appears to contradict the Commissions’ previous representations about the ability for informed Market Participants to “rely on” forecasts which are known to be subject to change.

Similarly it is unclear what the effect of a reference to “...*responses that reflect underlying conditions of supply and demand*” would be. There are likely to be a wide variety of interpretations as to what constitutes a response that reflects supply and demand versus a response that represents the commercial interest of different participants.

Stanwell considers that the current market design principles have served the NEM well over its history, and that a change is unlikely to be in the long term interests of the market (or consumers). If a change is considered necessary it should be limited to “... *providing timely forecast information to Market Participants*”.

4 Proposed additional reporting requirements

The draft determination proposes a new rules requirement that generators submitting bids close to dispatch must also submit a “late rebid report” to the AER. Stanwell consider that there are significant issues with the proposed requirement.

4.1 Draft determination circumvents NEM governance arrangements

One of the worst elements of the new requirement for a late rebidding report is highlighted in bold below:

*“...a more detailed report (a late rebid report), to be submitted within the time after the rebid specified in, and otherwise **to be prepared in accordance with, guidelines published by the AER...**”*

By creating a rules requirement to comply with a yet to be developed, regulator published guideline, the AEMC have delegated their rule making function to the body charged with enforcement of the rules. This is in direct conflict with the notion of separate bodies for rule making and enforcement as established under NEM governance arrangements.

Of particular concern in this regard is the significant divergence in position presented by the AEMC and the AER. While the AEMC have indicated that rebidding is a desirable aspect of the market and that rebidding close to dispatch is not of itself inappropriate or inefficient, the AER continue to present a view that generators are “doing something wrong” and that it is a failure of the rules that prevents them from penalising these generators. There is a clear risk that the AER will use these guidelines to deter rebidding activity that is in fact permitted (even encouraged) by the Rules.

Indeed when pressed at the recent public forum on what the AER would put into the guidelines the AER response was that they may consider incorporating the power to interview traders under oath – with specific reference to *Stanwell*. When challenged on their power to do so the AER immediately acknowledged that they may not have such power²², however the *intent* behind such a statement remains consistent with previous AER submissions and statements on rebidding and their powers.

At the same public forum the AER representative indicated that the regulator believed it required information allowing it to determine “*the event that lead to a rebid, its relation to the player (generator making the rebid) and whether the response was proportional and rational*”. We believe that such an approach would create a risk that traders become exposed to ex-post subjective analysis of whether their rebid was “right” or “optimal”, rather than whether it represented their intention.

Stanwell consider that, should the requirement for a late rebid report be retained, the AEMC should retain control of the rule making process, clearly defining the scope of the report in the rules. Clause 3.8.22(c)(2a) of the draft determination already contains what is close to an appropriate list of information for a “late rebid report”, namely

- (i) the material conditions and circumstances giving rise to the *rebid*;
- (ii) the *Generator’s* or *Market Participant’s* reasons for making the *rebid*;
- (iii) the time at which the relevant event(s) or other occurrence(s) occurred; and

²² Stanwell consider that the AER specifically *do not* have the power to do so, confirmed by the COAG Energy Council not committing to a rule change request to convey such powers in December 2014. Of the 13 commitments to rule changes requested of the Energy Council in this session only one other was not supported.

- (iv) the time at which the *Generator* or *Market Participant* first became aware of the relevant event(s) or other occurrence(s);

We consider that item (iv) in the list above may mischaracterise the decision making process of the trader, as they may become *aware* of a change but not actively consider it until any number of other processes are completed. For example if a change occurs and is indicated to continue for a number of hours or days (say a unit trip), the trader is likely to prioritise analysis of the nearest period or periods first. The trader would be *aware* that a change for other periods had occurred, but has not formed an intent to rebid in relation to those periods at that stage.

If required, the report should be simple to compile (and review) reflecting the reality that the regulator does not have any concerns with the majority of rebidding activity. In the rare instances where the report is not simply an administrative deadweight, the regulator could use its existing powers to request more information. We would expect this to occur no matter how detailed the automatically required report were to be.

4.2 Allocative efficiency gains through additional regulatory burden?

The Commission have created a draft rule which aims to discourage – through the imposition of undefined administrative burden – all rebids which occur close to dispatch. Such action is justified in the draft rule as both a means of providing information to the regulator and a “cost/benefit” deterrent for traders entering “speculative” bids close to dispatch.

The regulator already has, and uses, the power to acquire additional information from generators in relation to any rebids which are of particular interest, making the proposed benefits from information provision illusory. When the issue was addressed directly in the AEMC public forum, neither the Commission nor Regulator could identify a benefit to the AER from compulsory reporting of rebids made close to dispatch. Rather, the Regulator appeared concerned that the volume of reporting may be significant leading to consideration of exemptions for certain rebids or participants.

The remaining rationale – that administrative burden may inhibit rebidding – appears likely to be true, however this does not imply it is desirable. Attempting to improve the efficiency of a market by imposing deadweight administrative burden is misguided.

4.3 Undefined requirements create uncertainty regarding proposed benefit

The lack of definition regarding the requirements of a “late rebid report” significantly undermines the AEMC claim that the draft determination is in the long term interests of consumers. With this element unknown, there is no way to estimate the impact of the proposed changes or their cost.

As indicated in Section 2, the proposal that rebidding could lead to inefficient investment is not supported by market observations, even in the instances where inappropriate late rebidding is alleged to be occurring.

This creates an environment where the cost of the proposed rule change is unknown but potentially significant, and the benefit of the proposed rule change is unknown but likely to be negligible. Stanwell do not agree that such a change conforms to the NEO.