

COMPETITION & REGULATION UPDATE

REBIDDING IN THE NATIONAL ELECTRICITY MARKET –GOOD FAITH REBIDDING AND RAMP RATES

INTRODUCTION

The Australian Energy Market Commission (AEMC) is currently consulting on two related rule changes regarding rebidding in the National Electricity Market (NEM):

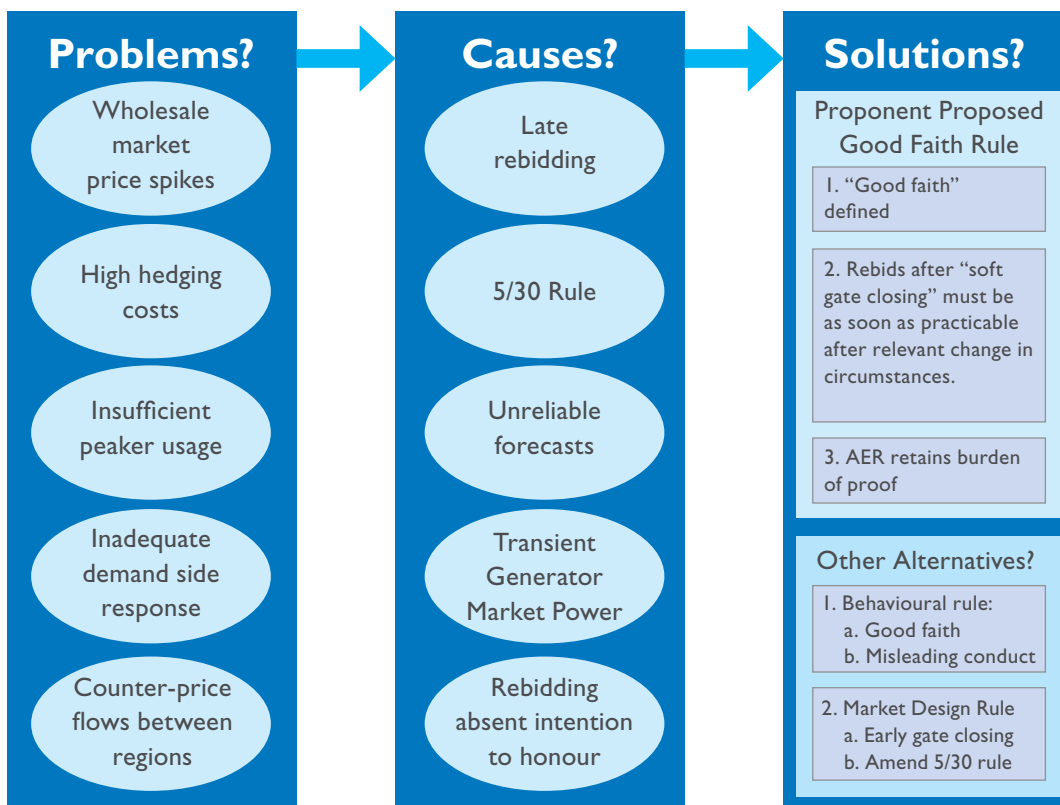
- Good faith rebidding requirement; and
- Ramp rates and dispatch inflexibility.

Both rule changes could have a significant impact on the bidding strategies available to generators. In our view, they should be considered together.

The NEM is complex. Problems are often multi-dimensional and solutions can create new problems. The below diagram and this publication, provide a short summary of the identified problems and suggested remedies.

IS THERE A PROBLEM?

Good faith rebidding



In November 2013, the South Australian Government requested a rule change (Proposed Good Faith Rule) following the decision in *AER v Stanwell* on the basis that the existing good faith rebidding requirement in clause 3.8.22A of the National Electricity Rules (NER) was not effective to prevent price spikes in the wholesale market caused by late strategic rebidding when other participants were unable to respond.

It is universally accepted that the ability for generators to rebid is essential. Indeed, competition demands it.

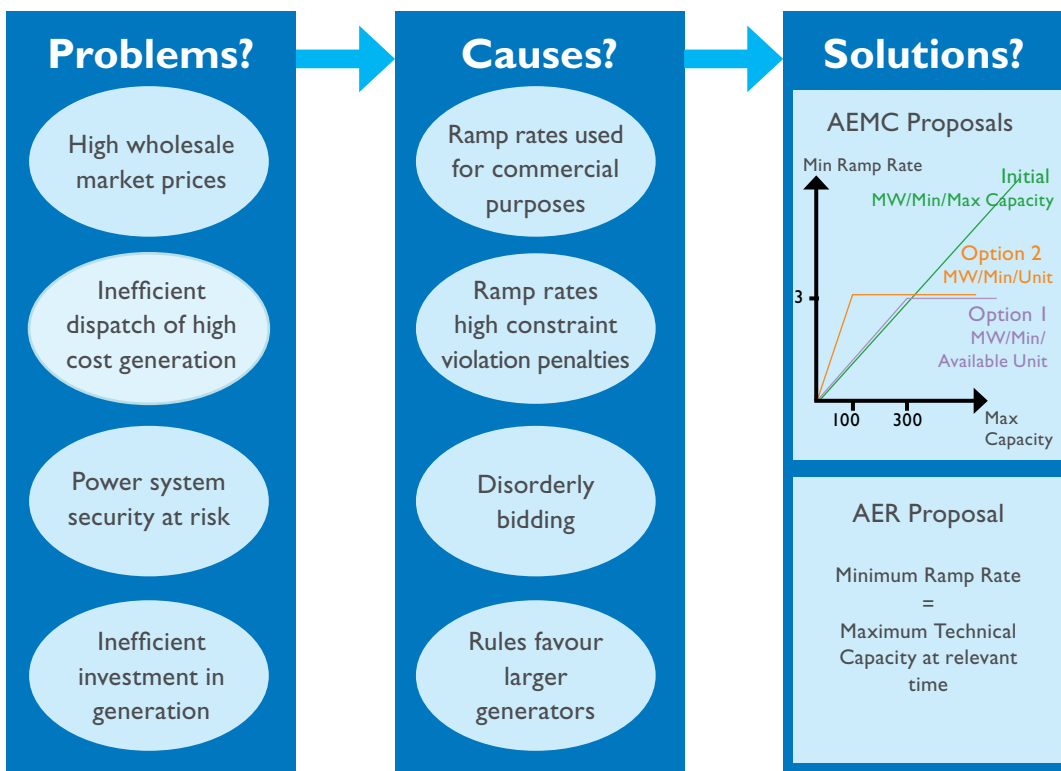
The question faced by the AEMC is whether rebidding should be constrained in some way, and if so, on what basis. In April and December 2014, the AEMC published a Consultation Paper and then an Options Paper which expressed some reservation regarding the Proposed Good Faith Rule and observed that short-term price spikes are not necessarily a problem. Specifically, the AEMC noted:

- overregulation of short term rebidding may jeopardise efficient long term investment signals;
- rebidding gives rise to legitimate price signals for investment (such as building to alleviate network constraints); and
- transient pricing power is an inherent feature of a workable competitive market.

However, the AEMC accepted that the efficiency of the market might be reduced if late strategic rebidding practices provide insufficient time for:


- fast-start generators to respond to price signals (for example because technical limitations prevent them from being dispatched at short notice or because they have minimum run times); and
- demand side participants to respond to price signals.

Ramp rate rebidding



In August 2013, the AER requested a rule change to prevent generators using ramp rates and dispatch inflexibility profiles (both of which it considers are “technical” parameters) for commercial purposes.

The AER identified various problems arising from that practice including inefficient dispatch of generation during times of congestion and the inability of the Australian Energy Market Operator (AEMO) to manage power system security efficiently. The AER also intimated that the good faith requirement may not apply to ramp rate rebids although that is not clear from the existing rules.



In August 2014, the AEMC released a draft rule determination. In summary, the AEMC considered that the existing rules were sufficient to ensure that AEMO can efficiently manage system security. Further, it was not concerned about generators using ramp rates for commercial purposes. Instead, the AEMC proposed a different rule designed to achieve generation technology neutrality in order to facilitate investment in the degree of ramp rate capability on the basis of market forces.

THE PROPOSED SOLUTION

Good faith rebidding


The AEMC identified two broad possibilities:

- A **behavioural rule** such as the Proposed Good Faith Rule. This could be based upon the intent of the generator (for example whether there was an intention to honour) or the impact on the market (such as whether a bid is misleading).
 - The Proposed Good Faith Rule:
 - Defines what is meant by “good faith” for the purposes of clause 3.8.22A(a) (in clause 3.8.22A(b));
 - Limits the circumstances in which a generator may rebid after a “soft gate closing time” (proposed new prohibition in clause 3.8.22A(e)); and
 - Expressly permits the Court to rely upon inferences (clause 3.8.22A(c) and (f)).
 - The Proposed Good Faith Rule would not solve all of the issues identified by the AEMC. Specifically:
 - In a practical sense, the most significant amendment in the Proposed Good Faith Rule is the requirement that generator rebids occur as soon as practicable after the material circumstances change comes to its attention. It is unclear how this clause will be interpreted where multiple circumstances change.
 - While the proposed reversal of the wording in clause 3.8.22A(b) has the effect of defining good faith for the purposes of clause 3.8.22A(a), it does not, in the AER’s view, have the effect of reversing the onus of proof.
 - In order to demonstrate a breach, the AER would therefore still need to demonstrate subjective issues such as the actual intention of the relevant trader in making a bid, whether particular circumstances are material and the time at which certain information came to the attention of a trader.
 - Other behavioural rules face similar difficulties regarding enforcement and certainty.
- A **market design rule** such as an earlier gate closing or amendments to the 5/30 rule would likely be more certain and relatively easier to enforce.
 - The AEMC raised the prospect of bringing forward the time for final generator bids. For example, the gate closing time is two hours prior to dispatch in Alberta and New Zealand.
 - The 5/30 rule could be removed, for example by aligning the length of dispatch intervals and trading intervals (for example, by facilitating virtual settlement for each five minute dispatch interval).

Ramp rate rebidding

The solutions proposed by the AER and AEMC address fundamentally different issues and have different consequences. Specifically:

- The AER proposal seeks to prevent generators using ramp rates for commercial purposes. It requires generators to submit as a minimum ramp rate the maximum technical ramping capability of the generator at the time.
- The AEMC proposals permit generators to use ramp rates for commercial purposes but seek to achieve competitive neutrality between different generators in respect of ramp rates. In August 2014, the AEMC proposed an alternative rule as follows. In December 2014, following consultation, the AEMC proposed two further options:
 - Initial AEMC proposal: Minimum ramp rate is:
 - 1 percent of the maximum capacity of the generator.

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- Option 1: Minimum ramp rate is the lower of:
 - 3MW **per unit** per minute; or
 - 1 percent of maximum capacity per minute per **available unit**.
 - Option 2: Minimum ramp rate is the lower of:
 - 3MW **per unit** per minute; or
 - **3 percent** of maximum capacity per minute.

DOES THE SOLUTION FIT THE PROBLEM?

Good faith rebidding

The Proposed Good Faith Rule would effectively require a generator to honour any bid or rebid if material circumstances remain unchanged.

At a practical level, the complexity of the NEM means that circumstances are continuously changing to at least some degree. In a particular instance, many of those circumstances may be material. Indeed, the actual conduct that the South Australian Government referred to in its rule change proposal involved generator **responses to changes** in market circumstances:

- A 2001 ACCC Report which focussed on high price events and found that while bidding and rebidding behaviour were major contributors to the high price events, the initiating cause was a physical event.
- A 2012 Special AER report which provides examples of generator responses to congestion and notes that generators that are forecast to be constrained have an incentive to rebid their capacity.

The AEMC consultation paper asks whether the real issues to be addressed are late rebidding and the “5/30 rule.” The AEMC considers that the good faith provisions may not discourage late rebidding. In this regard:

- An early gate closing time would provide demand side participants with additional time in which to consider a response. Although the ACCC previously rejected such an approach as it prevents participants taking into account late changes in information and may result in inefficient production outcomes, the AEMC observed that the gate closing time is much earlier in some overseas markets.
- Replacing the 5/30 rule with dispatch interval settlement and/or longer dispatch intervals, may reduce the incidence of spot price spikes by increasing the incentives for peaker generators to run. Specifically, removal of a 5/30 rule would give peakers greater confidence regarding the price that they would receive if they turn on. Modelling undertaken in 2002 concluded that such a change to the NEM would have an overall negative impact on the NEM largely because the upfront costs of altering IT systems were not outweighed by efficiency gains. However, both sides of that equation may have changed since 2002 due to factors like technological advances and altered in competitive dynamics.

Competition between generators is a fundamental tenet of the NEM. There is a risk that limitations on the ability of generators to rebid may detract from the degree of competition between generators in the short term.

Ramp rate rebidding

The solutions proposed by the AER and AEMC reflect a fundamentally different approach. The AER views ramp rates and dispatch inflexibilities as a technical parameters for use by AEMO in the efficient operation of the power system. The AEMC views ramp rates and dispatch inflexibilities as an aspect of the commercial bidding process.

A difficulty with the AER approach is enforcement, as physical ramping capacity is dependent upon a number of factors and may have commercial ramifications.

The AEMC approach permits generators to bid in a lower ramp rate if they choose (compared to the AER proposal). This allows generators to bid ramp rates for commercial purposes. For example, generators may alter their ramp rates depending on market circumstances and their own dispatch levels – for example, by reducing their ramp rates when they are being dispatched at high prices, thereby reducing the “market size” (ie the quantity of MW subject of the NEMDE “auction”).

CONCLUSION

For each of the proposed rule changes, there are a number of problems identified, a number of causes and various potential solutions. Furthermore, there are linkages between the two rule changes discussed in this paper. If the AEMC ramp rate proposal is adopted, the issues identified by the AEMC in relation to the good faith rebidding rule may be more pronounced. In consequence:

- The ramp rate rule should be considered in combination with the good faith rebidding rule change; and
- Solutions should flow from a careful identification of the specific problems to be addressed, and the underlying causes of those problems.

MORE INFORMATION

Please feel free to contact us should you wish to discuss issues associated with rebidding in the NEM.



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