

# **Australian Competition and Consumer Commission**

## **Authorisation of the National Electricity Code:**

Applications for authorisation Nos: A90797, A90798, A90799

### **PRE-DETERMINATION CONFERENCE**

**Tuesday 13 August 2002**

**Bendigo/Wangaratta Room**

**Hilton Airport Hotel**

**Melbourne Airport**

**Minutes**

John Martin, a Commissioner with the Australian Competition and Consumer Commission (the Commission) chaired the pre-determination conference.

The conference commenced at 9.00am Tuesday 13 August 2002

*Attendees:*

*ACCC Staff:*

- Joe Dimasi
- Michael Rawstron
- Donella Greer
- Alex Georgievski
- Mark Warren
- Justin Oliver
- Louis Tirpcou
- Renate Vogt

*Interested Parties*

Hon. Patrick Conlon (SA Minister for Energy); Russell Skelton (Macquarie Generation); Mark Williamson (NRG Flinders); David Briggs (NSW Ministry of Energy and Utilities); David Bowker (Hydro Tasmania); David Mawer (EMRF); John Dick (Energy Action Group); Paul Simhauser (Stanwell); Simon Maher (Southern Hydro); Ken Thompson (Loy Yang Power); Paul Hyslop (Edison Mission); Andrew Bonwick (Yallourn Energy); Stephen Orr (Hazelwood); David Headberry (ECCSA); Don Woodrow (Enertrade); Roman Domanski (EUAA); Henry Ergas (NECG); Rob Booth (Bardak Ventures); Michael Fraser (AGL); Stephen Kelly (NECA)

## **Hon. Patrick Conlon (SA Minister for Energy)**

- The SA jurisdiction does support the ability to rebid if it is done for good reason.
- Stated that it was clear that generators had market power and exercised this through rebidding. Noted grave concerns about this manipulation of the spot price to produce price spikes. This behaviour has been identified by NECA.
- The South Australian Government does support the flexibility allowed by rebidding.
- Stated that the SA Government does not support rebidding which creates price spikes while it did support generators making a profit. Stated that the SA Government considers price spikes to be a flaw in the market;
- Noted three major problems with price spikes:
  - 1- As SA has the peakiest demand, price spikes in the hot summer a few years ago increased retail contracts by 35%. Price spikes affected the average price of electricity which increased risk margins and the price of retail contracts. This was unacceptable given that Full Retail Contestability was being implemented in SA in January 2003;
  - 2- As far as the price spikes being a signal for investment, no commentator had said that the price spikes were not artificial. During May this year, the average price of electricity had doubled due to these price spikes;
  - 3- The SA Government was taking the situation very seriously. SA's confidence in the regulatory framework was at an all time low. Gaming was a key issue, and if not addressed, will cause a loss of confidence in the NEM. The situation may turn out to be more than just the Minister's problem; Minister Conlon emphasised that the public in SA are well aware of the rebidding debate and are not distant from the outcomes.
- Believed that bids should be made in 'good faith'. Questioned why this was so hard to accept. Under Corporations Law, Director's act 'bona fide' in the best interests of shareholders and the SA Government rejects that the term 'good faith' is unclear. Believed that people who say 'good faith' is unclear do not really mean this.
- Argued that there was a need for the proposals to go further. That there needs to be an evidentiary burden so that suspicious behaviour need be explained. Reverse onus of proof did not happen frequently but did happen.
- The Minister stated that there needs to be a structure in which bids and rebids occur where participants won't game the market.
- Believed that penalties need to be substantial considering the revenues received. Noted that the SA Government had no intention to punish generators but pointed to the fact that no generator had ever been prosecuted for gaming the market.

## **Russell Skelton (Macquarie Generation)**

- Stated that Macquarie Generation's concerns were somewhat different. Macquarie Generation was concerned with the process of the application, firstly because of the code changes being promoted by the MD of NECA and then approved by the Code Change Panel which he chairs, and secondly by the apparent desire by the ACCC to do something given the lack of supporting analysis to demonstrate that changes are necessary.
- The 'good faith' provision in the code changes is legally unworkable.
- Stated it was Macquarie Generation's view that the proposed code changes were the beginning of the re-regulation of the NEM.
- Noted that the ACCC's preference was for a structural solution and supported this view as it was the most efficient way. Suggested that the ACCC and NECA allow the market to work, which would facilitate investment and demand side management responses.
- Should also allow for greater interconnection between regions.
- Proposed that maintaining a stable regulatory environment supported new investment whilst the current determination detracted new investment.
- Stated that the Californian situation was one of re-regulation and what emerged was a range of price caps based on cost type pricing. Noted that cost justified bids were a step back to regulation.
- Argued that the problem of market power was unsubstantiated and the conclusions in the draft were not supported. No evidence demonstrating impact upon competitors or consumers.
- Stated that ACCC has adopted a policy role by proposing conditions that fundamentally affect the NEM. Governments should fill this role.
- Noted that Long Run Average prices did not create circumstances where generators can earn abnormal profits and that the Forward Curve has remained static.

## **Code Changes - General Comments**

### **Mark Williamson (NRG Flinders)**

- Stated that IES put a benchmark for base load new entry costs at \$40/MWh, OCGT (Open Cycle Gas Turbine) at between \$45/MWh and \$55/MWh and between \$35.5/MWh and \$46.5/MWh for CCGT (Closed Cycle Gas Turbine). Noted that MMA puts 'first year entry costs' at \$39/MWh and "levelised new entry costs" at \$42/MWh in SA.

- Argued that there were a number of new committed generation projects in all states except NSW since 2000. Noted that between 1 January 2001 and July 2002, the time weighted average pool price in NSW was \$36.21/MWh, \$35.76/MWh in Vic, \$40.42/MWh in SA and \$37.54/MWh in QLD.
- Drew reference to the IES report to the ACCC that in an energy only market it was necessary to have high and extreme price spikes to support investment in reliable plant. Noted that IES's assessment was that the level and duration of extreme prices in the NEM remained within the scope of reasonable expectations to achieve a reliable system.
- Stated it was unlikely that new entry (previous and expected) would have taken place without extreme price spikes including VoLL type events. Noted that in the ACCC's December 2000 VoLL determination, the Commission accepted that the proposed Code changes will increase investment in fast start plant as well as accepting the importance of pricing signals in the NEM. Put forth that in the NEM the price cap should be higher because of its energy only design.
- Noted that the problems with the pool prices were:
  1. Current time weighted spot prices were well under new investment prices;
  2. Current time weighted spot prices were insufficient to sustain the generation sector in the long term;
  3. If generators did not receive contributions from bids over \$500/MWh then the situation would be unsustainable for most generators now;
  4. Was it preferable to instigate new generation via price signals or via blackouts and reserve trader interventions?
- Stated that further dampening of time weighted prices was not required, and was unsustainable for generators with high fixed costs. Put forward that merchant generation was a risky business and it was important that regulators don't introduce inefficient and unnecessary risks. Concluded that the code changes would lessen competition by removing the price signal for new investment.

**David Briggs (NSW Ministry of Energy and Utilities)**

- Agreed with the previous speaker and reinforced that the NSW Government did not oppose rebidding, nor do they believe that generators should engage in behaviour that is inappropriate. Put forth the need for stability in market design and pointed to the dangers of tinkering with the market rules.
- Stated that any proposed changes should be properly assessed in accordance with good regulatory practice, this being:
  - 1) Quantitative analysis of costs and benefits;

- 2) Evaluation of market based alternatives;
  - 3) Assessment of unintentional adverse impacts, and;
  - 4) Outcomes should be clear and predictable.
- Put forward that the NSW Government promoted competition and that NECA and the ACCC had fallen short. Stated that in the NSW Governments view, it was not established that there was any problem with rebidding and that the focus on price spikes had lost sight of the problem.
  - Promoted a first best solution (including the promotion of new entry and further interconnection) and the use of the Trade Practices Act (TPA) which was already available. Supported the *principle* of 'good faith' but not as a specific market rule.
  - Contended that non-regulatory alternatives need to be looked at:
    - Structural solutions;
    - New entry;
    - Interconnection; and
    - Demand side response.
  - Considered that NECA and the ACCC had not looked at the impact of the code changes and questioned as to what sort of market would eventuate and how the rule changes would affect behaviour. Noted that the vast majority of rebids are beneficial and that NECA and the ACCC must take care to avoid unintended consequences involved in any rule changes that attempt to restrict bidding behaviour
  - Concluded by stating the NSW Governments preferred option for increasing the development of the NEM through first best responses.

#### **David Bowker (Hydro Tasmania)**

- Stated that it was up to the ACCC to look at issues of Market Power but questioned whether authorisation was the right forum for these NEM pricing issues.
- Submitted that the ACCC applied the test – do the Code changes 'adequately address the issue of market power' and that the ACCC must ask – does the public benefit from the new rules outweigh any substantial lessening of competition from the new rules?
- Considered that NEM pricing was an energy policy issue and not a rule change and should be looked at in the long run (10-15years) with a cost benefit analysis of any rule changes.

- The removal of volatility would be associated with higher average prices. Pointed to an ACCC 2001 report on petrol price volatility saying that consumers could benefit from volatility.
- Put forth that the NEM had delivered in providing the type of generation required in each state; both Victoria and South Australia had received the installation of peaking plant and Queensland have seen an increase in baseload generation.
- Stated that rebidding was vital for the efficient management of renewable generation such as hydro/wind and that the proposed changes would be detrimental to the development of the market.
- Considered that any concerns stakeholders had about rebidding could be addressed through the existing rebidding disclosure requirements and NECA market surveillance and pointed out that the TPA was the appropriate instrument to deal with any rebidding which involves a misuse of market power.
- Concluded that the NEM was only half a market and that the demand side was currently absent and would remain so without the right incentive, the right incentive being metering and price signals to cause impact and initiate a response.

#### **David Mawer (EMRF)**

- The Energy Market Reform Forum mainly comprises large industrial consumers who are effectively price-takers.
- Economic withdrawal by generators creates artificial price spikes in the spot market. This causes increased volatility in the market and as a consequence, risk levels and the cost of hedge instruments also increases. Increased volatility also discourages new investment.
- Demand side response requires a long-term approach. Large industrial consumers can not respond to fluctuations in the spot price in a half-hour interval.
- EMRF contends that compulsory pools are known to encourage gaming behaviour. Settlement Residue Auctions are also being gamed for speculative purposes and not for encouraging inter-regional competition as they were originally intended.
- Customers want strong action on this issue from both the Commission and the Code Administrator. If this action doesn't occur, trading arrangements in the NEM will need to be changed.
- EMRF considers that the ACCC should implement control measures such as those implemented in the United States.
- Longest contracts available in the NEM are three years. Large industrial customers need contracts for much longer if they are planning to invest.

## **John Dick Energy Action Group (EAG)**

- Contends that rebidding is only a small proportion of the problems that are causing an adverse impact on consumers.
- Considers that large customers are facing the risks of a volatile market, but these are not being felt by small customers. Large customers are paying high risk premiums in contract prices, but retailers are covering the risks for small consumers. These small consumers need to understand the supply side of the electricity market in order for demand side intervention to have any effect.
- The issue is much broader than just an energy market issue. There is a need to look much more closely at issues such as investment in transmission. Referred to Victoria, where \$5 billion dollars has been spent on network investment over a five year period.
- The ACCC is not the right organisation to be looking at this issue and is dealing with it in a piece-meal manner.

## **Variation of Offer, Bid or Rebid**

**Paul Simhauser      Stanwell**

- Mr Simhauser presented an assessment of benchmarks for bidding behaviour in electricity markets. His assertion was that a competitive benchmark in a gross pool market is not possible.
- Short run marginal cost has been pointed to as a solution. Mr Simhauser contended that SRMC pricing, even with VOLL price spikes is inadequate for the firm's survival.
- Went on to state that economic withholding has no clear definition in microeconomic theory, other than against SRMC, which is not sufficient to recover the firms' costs.
- To use the term "economic withholding" in the same sentence as "energy only market" displays poor knowledge of electricity generation fundamentals. The term 'economic withholding' is a contractual term used in US markets where capacity payments form a part of the generator revenue streams. Under these conditions, such a concept is acceptable since generators are being paid to make their capacity available at short run marginal cost. However, in the absence of capacity payments, economic withholding is synonymous with regulatory confiscation of generation capacity.
- Contends that economic withholding can not be measured with a static analysis and is only rational if there is a gross pool.

## **Good Faith**

**Simon Maher                      Southern Hydro**

- Contends that the term ‘good faith’ is ambiguous in the context of a competitive market and is usually confined to consumer transactions.
- Definition of good faith will be open to many different interpretations if it does not go through the authorisation process. Such an ambiguous term will lead to an increase in the cost of compliance and will be a legal nightmare.
- An ambiguous ‘Good faith’ provision could result in a significant loss of rebidding flexibility. This would result in a significant loss of system security and system optimisation. Increased conservatism in bidding behaviour would most likely result in higher average prices and would flow through to investment decisions.
- Mr Maher asserted that the ‘good faith’ recommendation does not address the perceived issue of market power. The status of the term needs to be clarified so that outcomes are clearer and more predictable.
- To date there has been no evidence to suggest that bids have not been made in good faith. The ACCC should not authorise a non-specific provision for bids to be made in good faith. Specific proposals should be made and these should be tested against the public benefits test.

## **Conduct Prejudicial to the Market**

**Ken Thompson                      -                      Loy Yang Power**

- Mr Thompson discussed two main topics
  - (1) the proposal to delay the disclosure of NEM bid data, and;
  - (2) the proposal to require compulsory disclosure of contact positions.
- Asserted that retailers rely on the quick disclosure of bid data as well as generators. Delaying the availability of such data will adversely impact the overall efficiency of the market.
- Gave an example of how loss of security of supply could occur as a result of deferring the release of bid data – due to the potential masking of signals which may incentivise supply availability or demand side responses..

- Some contracts are tied to information contained in bid data. Restricting the availability of this information will effect the liquidity of contract markets. Robust, liquid markets are required to produce competitive outcomes.
- Delaying release of data may also have unintended impacts on other parts of the market, eg. the ancillary services markets.
- The market is currently one-sided. There is a need for greater transparency from the demand side. The proposal also seems contradictory to the recent Financial Services Reform Act where greater transparency is being sought.
- Mr Thompson contends that bidding behaviour produces competitive outcomes and does not foster tacit collusion. In fact, most rebidding results in a lower spot price, so why tamper with the mechanisms?
- The delay of bid data will most likely have a greater effect on smaller players as it will prevent them optimising their production; this has been the experience overseas where the larger players are better resourced to manage in an environment where there is less information. The delay doesn't affect the use of market power, it actually inhibits a competitive response.
- If market power exists, lack of disclosure will promote it.

On the issue of contract disclosure to NECA;

- The proposal for contract disclosure is invasive and inconsistent with the concepts of light-handed regulation.
- It is not possible to determine a generator's bidding strategy from its contract position alone; a range of other drivers and/or products will influence this, eg business plan/market positioning, emotion or perception based issues, fuel supply matters, weather derivatives, current and future hedge positions, etc
- Non-pool participants may be advantaged, as they would not be scrutinised by NECA.
- If NECA obtained data on the contract position of a generator, it is unclear by what criteria it could determine the impact on bidding from instruments such as swaptions, Asian options, some caps and floors, look backs, and a range of other complex products..
- Confidentiality concerns may result in commercial outcomes being compromised at some time.
- Disclosure may inhibit generator speculation on the OTC market thereby reducing contract liquidity and impacting the availability of intermediaries trading in the OTC market.

## **Response from SA Minister for Energy – Hon. Pat Conlon**

- Generators continue to assert that there is no problem, but there most definitely is, and they should start to co-operate in order to find a reasonable solution.
- A reasonable solution could be replaced with a more heavy handed approach down the track because of increasing political pressure.

## **Market Power**

### **Russell Skelton (Macquarie Generation)**

- Considered that if one was to look at concentration levels based on installed capacity, Macquarie Generation had 12% market share and Delta 11%, Compared to ACCC CR4 test concentration levels this would be acceptable, whilst that of the largest generator in the UK had 17% market share in the UK market. Pointed out that the UK market was fairly competitive.
- Stated that 95% of the time transmission into NSW unconstrained and 83% of constraints that have occurred in NEM are at prices less than \$20. This implies that the NEM is effectively unconstrained at times of high prices and Macquarie Generation still has a 12% market share at these times
- Stated that this does not seem to support a view that there is a problem with market power.
- Stated that the benchmarks for the cost of generation were \$43 MW/h according to IPART and \$39 MW/h according to SKM and that compared to 12 month rolling average pool prices there is no evidence of market power
- In addition that increases in prices were strongly correlated with reductions in reserve levels
- Pointed to the performance of government trading enterprises in that they were under performing given the average return for regulated assets was 8% again this demonstrates there is no evidence of market power
- Concluded that a lot more analysis needed to be done into this issue.

### **Paul Hyslop (Edison Mission)**

- Considered the NEM to be a world leader in electricity market design in terms of economic efficiency.

- Pointed out that as the NEM was an energy only real-time market there was no guarantee of operating costs in the event the spot price was low.
- Put forth that other markets were playing catch-up or had been derailed by political and regulatory intervention. Considered that the majority of markets were not relevant when considering restricting or imposing conditions on rebidding excepting NZ. Stated that NZ was also an energy only design with a voluntary pool and that all major players participated through the pool. Stated that it was an ex post energy constrained market not short of capacity.
- Described the UK market as having a long history of regulatory interference due to a “noisy” regulator and failed to deal with the real issue of duopoly. Stated that OFGEM had attempted to incorporate ‘market abuse’ clauses in licenses but lost cases in the courts as well as attempting to incorporate ‘market abuse’ clauses in legislation but concluded that divestiture had led to lower prices and not regulatory intervention.
- Described the Californian market arrangements as dysfunctional as they tied the hands of retailers inhibiting the hedge market. Stated that the market currently has a Must Offer Obligation and Damage-Control Price Cap (DCPC) of \$108 MWh whilst the proposed arrangements were for a capacity obligation and energy market with the DCPC to be lifted over time.
- Stated that according to the Enron hearing the inefficiencies were built into the Californian market design and that such operators as Enron did not go into efficient markets but rather went into inefficient markets to exploit these inefficiencies.
- Put forth that a number of the costs in the Californian market including start up costs and guarantees for operating costs as well as a separate capacity market had been socialised.
- Stated that the NEM minimised the socialisation of costs, which were primarily only network charges and that the cost of capacity must be recovered through the energy price. Concluded that Australian regulators were ‘cherry-picking’ individual features from other markets and that electricity pricing was a market out-turn that provided the investment signal to maintain power supply reliability at the level that power consumers required.

#### **Andrew Bonwick (Yallourn Energy)**

- Considered that the market structure of the contract market displayed no barriers to entry and perfect information in the form of several indices and simple products. Stated that the loss of Enron had been felt in the market but that there were still a number of retailers, generators and intermediaries along with 6 brokers, which was over-brokered in comparison to the UK market.
- Put forth that the quarterly OTC contract market was very liquid and that the SFE had traded electricity futures contracts since 1999 although its product design did

not aid the liquidity of this market. Stated that the ASX had developed a revised structure which may aid the contract market?

- Stated that AusPower was a specialist large industrial retailer with sales in NSW, ACT, Queensland and SA. Whilst Yallourn only generated in VIC (at present) the contract market had been efficiently used to hedge this significant presence outside of VIC.

Concluded that the major issue was not the contract market structure but rather the ownership structures and vesting arrangements given ETEF and the Queensland rules on valid counterparties.

### **Stephen Orr (Hazelwood)**

- Supported the market forum as an alternative to confrontational regulation because intrusive and uncertain regulatory intervention deters investment.
- Considered the issues of rebidding and market power were divisive in the electricity market and that participants and regulators should work together to ensure appropriate behaviour.
- Stated that the Commission's consultation highlighted a lack of general understanding of the issues around market design, market power and rebidding. Put forward that this lack of understanding unnecessarily spooked end use customers, threatened conservative and uneconomic behaviour from generators, pre-empted intrusive regulation, which would lead to the inclusion of significant regulatory risk in investment assessments. Considered this to be a barrier to entry.
- Highlighted that the outcomes of the proposed Code changes could be different to expectations, with a more rigid environment for generator bidding resulting in higher spot market prices.
- Concluded that he supported a unique cooperative approach to market behaviour regulation in the form of the proposed forum, but that this required:
  1. A structure that would provide the opportunity for all market participants to air their respective views;
  2. Mechanisms that free participants to discuss behaviour "without accompanying concerns of enforcement action" (quotation from the Draft Determination);
  3. A 'no-regrets', forward looking approach to prescribing behaviour;
  4. Not intended to subvert the application of the TPA; and
  5. That rule changes would still need Code consultation processes.

## **David Headberry (ECCSA)**

- Outlined a history of the rebidding debate and stated that the selected option was failure and that all that was being done was to monitor generator market power.
- Considered that rebidding was unique to the electricity industry and that in all other industries a commitment to one bid was required before allowing another bid. Stated that rebidding and capacity withholding were manifestations of market power held by generators. Put forth that a review of the recent antics of the market clearly showed the generators are exercising market power.
- Submitted that the code needed changing and that by recommending changes to the code, NECA and ACCC both accepted that the code was deficient. Stated that economic withholding of capacity must be prevented.
- Considered the current proposals had been watered down for authorisation and that the ACCC had watered these down even further whilst generators were maximising profits during winter when there was surplus capacity around. Put forward that a new, stronger prescription was needed before the advent of the coming summer.
- Discussed the NEM Ministers Communique of 19 July 2002 and that the Forum considered that the work of NECA and the ACCC to date has not yet achieved a satisfactory resolution of this issue. Restated that the NEM Ministers called on NECA and the ACCC to develop further Code changes to address inappropriate bidding and rebidding and that significantly higher penalties should be imposed.
- Pointed out that a failure to act would result in:
  1. Generators continuing to exercise their market power;
  2. Unacceptably high contract prices;
  3. Industrial investment being depressed;
  4. Governments being forced to act;
  5. Regulators given powers to control prices;and
  6. Wholesale change to the electricity market structure.
- Stated that the code needed controls, surveillance and monitoring as seen overseas and enforcement with muscle with penalties reflecting the rewards. Concluded that a task force needed to be convened to establish reasonable limits for rebidding, withdrawal of capacity and capacity withholding. The taskforce should comprise generators and consumers

## **Other Issues**

### **Don Woodrow (Enertrade)**

- Mr Woodrow stated that the market's success relies on its rules not only being obeyed, but made properly. Mr Woodrow contended that by making suggestions in the Draft Determination for further Code changes the ACCC is not making rules properly. He said that this is a grave development for an industry where a sound rule making process is required to attract and retain investment.
- First, Mr Woodrow argued that the ACCC is acting outside its legislated scope by engaging in market design work in pursuit of a policy goal it has adopted. Second, he stated that the making of suggestions creates a conflict of interest because the ACCC will need to assess applications for authorisation of any Code changes based on their suggestions. Third, Mr Woodrow stated that the Code provides it is not intended to address anti-competitive behaviour, and that the Trade Practices Act or jurisdictional law should be used to address any such behaviour in the NEM. He said that this has been ignored and expressed concern that the ACCC was using suggestions for Code changes to expand its role beyond that in the Trade Practices Act.
- Mr Woodrow asserted that the ACCC's draft determination begs more questions than it answers. In that regard he stated that there is a significant lack of analysis in the draft determination. Without an analysis of costs and benefits, the suggestions cannot be valued. He indicated that the case for the suggestions therefore had not been made in the Draft Determination.
- Mr Woodrow concluded that very existence of the Commission's suggested Code changes has increased the regulatory risk faced by current and potential investors in regard to this and future authorisation processes.

### **Roman Domanski (EUAA)**

- Mr Domanski agreed with the ACCC on the issue of market power and the detrimental impacts of rebidding. However, there is a concern that not all of the associated issues are on the table at once. The ACCC is forced to act on incomplete proposals.
- The Commission has to act upon that which it can achieve given the circumstances.
- The ACCC has done too little in regards to the rebidding issue in the belief that the problem is dissipating or will be fixed by others.
- Mr Domanski asserted that in New South Wales, half the available capacity is regularly bid in at prices over \$5,000 and that this is often targeted at the 6pm evening peak. The new VOLL has assisted such behaviour, and generators in the other states have begun to adopt similar tactics.

- This has seen a hardening in retail contract prices. Suspicious bidding activity is causing significant increases in risk premiums.
- To “do nothing” about this issue is not an option. The provisions requiring generators bids to be made in good faith are necessary. There is also a need for increased market monitoring by NECA. Action should be taken now, even with the risk of less than ideal solutions.
- Contract information should be disclosed to the regulator and there needs to be a limit on information disclosure so as to limit gaming opportunities.
- There also need to be more specific restrictions in the short-term to prevent economic withholding, ramp-rate bids below normal and high priced “sleeper bids”.
- The penalties for code breaches are not enough of a disincentive. The potential rewards from gaming the market are much greater than the penalties. Specific reference to the recent case against Macquarie Generation. Mr Domanski asserts that the penalty of \$10,000 in that instance was a “joke.” The regulators also need to take on a much stronger enforcement role.
- Action also needs to be taken to address market power in the future. There are currently problems with market structure and ownership of assets within the NEM. More interconnection and demand side management is required. Regulators should look at reducing the level of VOLL.
- The problems allowing the Settlement Residue Auctions to be gamed should also be addressed.
- Contract markets need to be enhanced and greater liquidity is required. This would help address the issue of market power.

### **Henry Ergas (NECG)**

- Generators have allegedly used market power but have consistently received returns that are low relative to WACC.
- Prices are below new-entrant cost which is also inconsistent with claims of use of market power.
- Rebidding more often than not reduces price volatility and helps ensure that there are appropriate signals for new investment.
- The 365 day moving average of NSW spot prices demonstrates that a substantial upturn in demand explains the recent upswing in prices. Recent behaviour is consistent with historic norms.
- There is no evidence that opportunity costs are not being revealed in the NEM. Criticisms of the pool are misplaced and poorly founded.

- Full disclosure of trading information, as currently occurs, can facilitate collusion, but it can also enhance market efficiency.
- There is no evidence to support allegations of tacit collusion in the NEM.
- As a result, there is no evidence that there are any benefits to be gained from non-disclosure, but there are definite costs.

### **Robert Booth (Bardak Ventures)**

- Dr Booth contends that there is significant evidence that incidence of price spikes in the NEM is increasing.
- More generators are engaging in gaming behaviour. The conduct began occurring in the early part of 2001, and has continued since then.
- The design of the market is such that the generators do not have to communicate in order to know what actions each other will take.
- The artificial price spikes that are occurring in the NEM do not provide the appropriate signals for investment. The spikes are occurring when reserve margins are greater than 30% and at weekends.
- The figures presented by generators as the new entrant cost are inaccurate and too high. Generation types other than base-load need to be considered.
- Even small players can effect the spot price by withholding capacity.
- Generators' claiming not to be making abnormal profits is misleading. Dr Booth cited the \$100 plus profits declared by NSW generators last year with average revenues of just \$33-34/MWh.
- The costs incurred by a retailer are more than just the cost of energy. Risk cover is expensive. Retailers will claim that their costs are much higher.
- Inappropriate decisions have been made in some states in regard to investment in generation. Customers should not be forced to pay high prices to compensate for poor commercial decisions.
- Dr Booth supports the idea of a market forum where issues such as rebidding and price spikes can be addressed in greater depth.
- Restrictions on rebidding are necessary when there is a compulsory pool. Other approaches would be the implementation of capacity payments or changes in pool design.

### **Michael Fraser – (AGL)**

- Mr Fraser agrees with the SA Minister for Energy that rebidding is essential, it helps generators receive a reasonable return and allows appropriate price signals to be sent.
- Rebidding helps maintain an appropriate balance between demand and supply. But the market should deliver appropriate wholesale and retail prices. It is expected that nobody should be able to exploit their market power.
- The rebidding debate should be conducted with consumers in mind. Consumers want fair, reasonable prices and the lights to stay on.
- The “good faith” provision needs to have clarity and give certainty to the generation sector.
- A thorough analysis of the issues needs to be made. We cannot afford to make the wrong decisions.

### **Stephen Kelly (NECA)**

- Bidding and rebidding should not be looked at in isolation. The broader picture needs to be given consideration.
- That broader picture should encompass a range of complementary actions including the introduction of capacity mechanisms and a code of conduct as well as black letter law.
- NECA has recently published an options paper floating a financial market-based approach to capacity mechanisms intended to dampen extreme volatility and reduce related risks in the spot market, provide a longer-term and smoothed approach for price signals for new investment in generation and sufficient incentive to secure adequate reserve capacity in a timely and orderly way.
- It is unrealistic to take away the volatility and still expect to attract new investment to the market.
- It has always been inferred by the code that “bids and offers are firm.” This code obligation has been eroded. The “good faith” provision is intended to restore the obligation on generators to make bids & rebids that are firm.
- Mr Kelly referred to research completed by a number of independent parties into the behaviour of generators, including; ABARE, Bardak Ventures and IES. This research seemed to point to generator’s behaviour, particularly economic withholding, as the cause of artificial price spikes in the NEM.

- Mr Kelly also pointed to a number of sources emphasising the need for market rules to ensure the efficiency of the market is restored. These sources included FERC and ACCC.
- Ministers had made clear that, as a matter of policy, they oppose generator bidding and rebidding strategies that are inconsistent with an efficient, competitive and reliable market such as those not made in good faith, the blatant economic withdrawal of generation and the gaming of technical constraints. Ministers had called on NECA and the ACCC to develop further Code changes that will address inappropriate bidding and rebidding and enable commensurate penalties to be enforced.
- The gaming of technical constraints and their relationship with the bidding/rebidding strategies of generators needed to be tackled. These problems could be addressed through requirements for generators to use inflexibility as a reason for a rebid only when there are abnormal plant conditions. Ramp rates should also be consistent with the plants registered abilities.
- The disclosure of contract information on a confidential basis would assist NECA and the National Electricity Tribunal when conducting specific investigations. A broader approach to disclosure of market information should be considered as part of a market review forum.
- There should be an “enhanced duty of care” when the market is operating outside its normal “competitive price envelope.” NECA proposed defining this envelope to reflect the upper bound of competitive prices based on bootstrapped correlation between price and output by season, and by region.
- NECA supported the proposed market review forum.