



12 February 2015

Mr John Pierce  
Commissioner  
Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

Submitted online: [www.aemc.gov.au](http://www.aemc.gov.au)

Dear Mr Pierce

**ERC0166 – Bidding in good faith Options Paper**

Origin Energy (Origin) appreciates the opportunity to provide comments to the Australian Energy Market Commission (AEMC) Options Paper on bidding in good faith.

Origin supports the assessment approach set out in the Options Paper which reinforces the importance of clearly demonstrating the existence (and materiality) of the problem the proposed changes are intended to solve. Of equal significance is the need to determine if the proposed options will result in net market benefits. With this in mind, Origin does not consider there is a case for increased regulation around generator rebidding. Analysis commissioned by the AEMC has shown that the incidence of late rebidding across the NEM has been low. Given that not all late rebids result in an increase in price, the instances where late rebidding results in higher prices would be lower still. To get to the behaviour that is of concern to the Rule change proponents the AEMC would then need to distinguish between efficient high prices due to late rebids, and high prices that are as a result of late strategic bidding. Given that the latter is a subset of what is already an infrequent activity, it is difficult to argue that later strategic bidding is a significant issue for the market.

Another important consideration is that the proposed regulatory responses have the potential to introduce a greater level of market distortion than the behaviour they are seeking to curtail. Imposing bidding restrictions on all generators operating in the NEM as a means of limiting strategic bidding is a disproportionate response. Proposals to intervene could however create losses in productive efficiency through restricting the ability of generators to respond to changes in circumstances leading to inefficient prices. With the increasing uptake of intermittent generation such as wind and solar PV, the ability to rebid provides a critical tool for generators to adapt to changes in the market, ensuring market stability.

Should you have any questions or wish to discuss this information further, please contact Ashley Kemp on (02) 9503 5061 or [ashley.kemp@originenergy.com.au](mailto:ashley.kemp@originenergy.com.au).

Yours sincerely,

A handwritten signature in blue ink, appearing to read "Steve Reid".

Steve Reid  
Manager – Wholesale Regulatory Policy  
Energy Risk Management

## 1. *Is late rebidding and issue that warrants regulatory intervention?*

The concern expressed by the AEMC in the Options Paper is around instances of so called late strategic bidding where generator rebids close to dispatch are deemed to prevent other market participants from responding. There are a number of factors, however, that must be taken into consideration in assessing the materiality of this issue, including the frequency and consequent impact of late rebids.

### 1.1 *Late rebids are not necessarily inefficient*

It is important to establish that late rebids do not necessarily equate to inefficient market outcomes. A ROAM Consulting study on behalf of the AEMC found that – *'late rebidding quite often has a role to play in responding to price spikes in pre-dispatch forecasts and reducing market volatility'*<sup>1</sup>. This highlights that by enabling generators to respond to changes in market circumstances, late rebids assist in promoting market stability and efficiency. Additionally, though much of the focus is on times where late rebids result in higher spot prices it is worth noting that this is not always the case. Analysis by the Australian Energy Market Operator (AEMO) showed that in both NSW and Victoria late rebidding actually resulted in lower pricing outcomes in 2013.<sup>2</sup>

Even where late rebids lead to an increase in the spot price, this has proven to be minimal, and it cannot be automatically assumed that this is as a result of strategic bidding or that this higher price is inefficient. In an energy only market such as the NEM a late rebid and subsequent increase in prices can be as a result of any number of factors such as transmission constraints, generator outages, or an increase in demand. It therefore means that a simple observation of higher prices following a late rebid does not provide sufficient information to determine that this is problematic for the market.

Origin agrees with the AEMC's conclusion that the market is never fully efficient and that overshoots and undershoots are a normal feature of the iterative price discovery process<sup>3</sup>. We take this to mean that in markets such as the NEM, prices over short periods of time are likely to deviate from an efficient pricing level - even in the absence of late rebidding.

In our view, the pricing issues around late strategic bidding are analogous to transient pricing power in that both can result in short term price increases. Under the previous consultation into potential generator market power, the AEMC determined that transient pricing power is an inherent feature of the market. The AEMC also made a distinction between transient pricing power and substantial market power which involves the ability to sustain prices above LPMC for a significant period of time. It is the exercise of substantial market power that is problematic for the market. There is no evidence to suggest that late rebidding has resulted in the exercise of substantial market power and an uplift in wholesale prices above a long run efficient level. It is this long term outlook that should guide decision making around the need for intervention.

### 1.2 *Incidence of late rebidding is low*

So whilst it is not prudent to presuppose that late rebidding will lead to adverse market outcomes, in any case it is worth noting that the actual incidence of late rebidding has proven to be minimal. The aforementioned ROAM Consulting analysis found that:

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<sup>1</sup>AEMC 2014:Options Paper: National Electricity Amendment (Bidding in good faith) Rule 2014, pg 20

<sup>2</sup> *Ibid*, pg 38

<sup>3</sup> *Ibid*, pg 16

*There is little evidence since 2007 of a systematic tendency across the NEM of generators rebidding towards the end of trading intervals and rebidding just prior to dispatch, with the exception of more recently in Queensland, and to a lesser extent in South Australia<sup>4</sup>*

The above finding is crucial in that it demonstrates there is no general increase in late rebidding in the NEM, and that the occurrence of this type of behaviour tends to be the exception rather than the norm. Though this should not be the only consideration, it is likely to be indicative of a problem that is not of sufficient magnitude to warrant an increase in regulation. This is particularly the case given that only a subset of the already limited number of late rebids are likely to result in inefficient high prices.

Origin notes that ROAM's analysis does indicate that in recent times the frequency of late rebids has been greater in Queensland when compared to the rest of the market. Whilst we take the point that the regulatory framework must be robust across all NEM jurisdictions, we caution against any rush to change the current rules to address this anomaly. In our view a critical first step should be to examine the underlying reasons for Queensland's divergence from the national trend, such as the extent to which any structural issues, or transmission constraints, have contributed to an increase in late rebids. This would allow for a more targeted and appropriate response to this issue. Imposing added regulations on the entire market in response to a possible deficiency in one region, is a sub-optimal outcome which would result in a decrease in market efficiency overall.

### *1.3 Late rebidding and the ability of market participants to respond*

The primary concern around late rebidding is that any resultant price increase does not allow for a response by other market participants. The NEM by its very nature, however, is subject to a degree of volatility and unpredictability and so the ability to perfectly predict spot pricing outcomes is limited even where there are no impediments to market efficiency. As we have mentioned previously there can be a number of legitimate factors that results in a late rebid and an ensuing price spike. We note that the AEMC also acknowledges in the Options Paper there will always be one generator that makes the last rebid in any dispatch interval. It therefore means that an inherent feature of the NEM design is that not all market participants will be able to respond to a rebid. Given this, Origin questions the rationale of using this issue as the basis of any regulatory intervention.

The Options Paper highlights the inability of demand response (DR) proponents to respond to late rebids, and that the incidence of late rebidding has curtailed the uptake of DR in the market. There is always likely to be some limitation in the ability of DR to respond in a dynamic market such as the NEM. Ironically the limiting factor to the increased uptake of DR has been the benign market conditions and lack of volatility brought on by the oversupply in the market. If the reasoning by some DR proponents is that late rebidding can result in inefficient high prices (that would have not otherwise occurred), we do not consider the inability of DR to respond to these prices as a market failure given that this should not impact the allocative efficient level of DR.

## *2. Proposed regulatory interventions will increase market distortion*

Rebidding is critical to effectively operate in the NEM and provides generators with the flexibility to adapt to a number of changing factors such as physical plant conditions, fuel availability, transmission constraints, and demand. Origin is therefore wary of any proposed changes in the Rules that would seek to limit rebidding. We are concerned that the market distortion from such a move would outweigh any inefficiency that may be created from the limited instances where late rebidding could result in inefficient high prices.

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<sup>4</sup> AEMC 2014: Options Paper: National Electricity Amendment (Bidding in good faith) Rule 2014, pg 20

With the increasing penetration of non-scheduled distributed and intermittent wind generation and solar PV, rebidding is even more important to efficient market operation. The sometimes unpredictable nature of wind and solar PV means that thermal generators require the scope to respond to fluctuations in supply. Rebidding, (and indeed late rebidding) would allow for this to occur, and is crucial for the stability and security of the system as well ongoing reliability. Limitations on rebidding also have the potential to result in higher prices and losses in productive efficiency as Frequency Controlled Ancillary Service (FCAS) markets are required to make up any shortfall that would have otherwise been supplied in the energy market.

### *2.1 Behavioural statement of conduct*

Origin supports retaining the current good faith provisions. Whilst recognising the concern the proponents have with the possible precedent set by the previous Federal Court decision in the Stanwell vs. AER case, one failure to secure a conviction does not lead to the conclusion that the existing provisions are inadequate. Given the occurrence of late rebidding is generally low across the NEM, and that the incidence of strategic bidding is lower still, we do not see a compelling reason to deviate from the current arrangements.

While we have some sympathy for the AEMC's attempt to enhance the good faith provisions by exploring the possibility of a behavioural statement of conduct, this is likely to result in unintended consequences. The Options Paper suggest that a behavioural statement of conduct could seek to target generator behaviour that could lead to the creation of false expectations, with a plan for the regulations to focus on the observable actions of the generator as opposed to seeking to determine its specific intention. This suggests that any generator that makes a late rebid resulting in an increase in price could be in breach of the statement of conduct if the higher price had an adverse impact on a market participant. Even if allowances are made for rebids that are made for 'legitimate' reasons, it would still mean that the generator would be forced to prove its innocence which takes us back to the issue of a reversal of the onus of proof. This would curtail rebidding, and is not in the best interest of the market.

### *2.2 Restrictions on bidding close to dispatch (gate closure)*

Origin does not support the imposition of a gate closure mechanism on the market, and questions how this would lead to an improvement on the status quo arrangements. We have previously discussed the importance of generators having flexibility to respond to changes in the market. Restrictions on bidding close to dispatch would recklessly curtail generators' ability to react to such changes. It is also not clear how gate closure would limit any late rebids that would have resulted in an increase in price given that irrespective of the cut off period for rebids, the last generator may still be in a position to place upward pressure on prices.

The purported benefit of gate closure is that it would allow for a physical response by peaking generators and DR proponents to a late rebid. These market participants would have greater scope for a physical response where there is a longer window of time under which rebids are restricted. The longer the period of restriction, however, the greater the likelihood of distortions in the spot price due the inability of generators to respond to changing demand and supply conditions. Such an outcome is likely to have a greater distortionary effect on the market overall compared to any issues associated with late rebidding. There does not appear to be a reasonable scientific approach to determine the cut off period for rebids under gate closure. Any such period is likely to be arbitrary, and at odds with the NEM design.

The Options Paper outlines a number of alternatives for restricting rebidding that could apply to a gate closure mechanism. Clearly the greater the restriction, the more adverse the market impact is likely to be. For example we consider restricting rebidding to only

instances where there is a failure of a physical unit or other technical parameters as inefficient. Such restrictions would force generators to commit a unit or level of output utilising imperfect information. As highlighted in our previous submission, a trader's subjective expectation is critical to maximising productive efficiency. In practice, this enables a trader to progressively bid units and capacity until the traders' expectation is realised, producing savings in fuel and start-up and running costs from locking in what may be an inefficient level of generation prior to gate closure.

Whilst being the least intrusive of the options for gate closure, Origin has concerns around calls for an increase in reporting requirements to support rebids. An increase in the compliance burden could result in more conservative rebidding which would limit the ability of generators to respond to changing market conditions.