



22 May 2014

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

Submitted online: www.aemc.gov.au

Dear Mr Pierce

ERC0166 - Bidding in good faith

Origin Energy (Origin) appreciates the opportunity to provide comments to the Australian Energy Market Commission (AEMC) Consultation Paper on bidding in good faith. Origin does not support the proponents rule change proposal and if implemented could be detrimental to achieving the National Electricity Objective (NEO) through not promoting the efficient operation and use of electricity services for the long term interest of consumers.

The objective of the proposal is to address short term instances of strategic bidding however it fails to recognise the benefits and efficiency of the existing National Electricity Market (NEM) arrangements. The proposal could create unintended consequences and inefficiencies through:

- Imposing restrictions on rebidding could lead to inefficiencies in dispatch and spot market outcomes and increase the cost of ancillary services; and
- Increasing the compliance burden on generators could directly increase costs that could be reflected in the contract market where generators adopt a more conservative bidding and hedging strategy to comply.

Origin considers the proponents have not demonstrated a market failure to justify an increase in intervention and compliance obligations to restrict generator rebidding. Any potential gains from the proposal are likely to be elusive with losses in efficiency in dispatch and spot market outcomes with increases in compliance costs for generators.

Rebidding is critical to effectively operate in the NEM and provides flexibility to reflect changes in physical plant conditions, fuel availability and manage commercial considerations. The proposed restriction could lead to inefficient dispatch, sub optimal spot market outcomes and increases in ancillary services charges when generators adopt more conservative bidding strategies to comply with the proposal.

Origin has developed a positive compliance culture and implemented bidding controls to maintain compliance with requirements under the National Electricity Rules (NER or Rules). Trader training reinforces the good faith provisions under the NER with having a genuine intention to honour a rebid. The success of Origin's compliance culture and bidding controls is reflected in Origin not breaching the Australian Energy Regulator's 'three strike' policy since June 2011 submitting approximately 120,000 bids and rebids¹

¹ As a large and diversified generator Origin submits around 40,000 bids and rebids per year.

without infringement. The number of rebids reviewed by the AER for the NEM as a whole has declined significantly since reporting commenced in 2010 with an increase in the number of market participants self-reporting to the AER over this period.²

Given the proponent have not identified a bidding or rebidding compliance problem imposing additional requirements is disproportionate. Requiring traders to compile and keep records of complete information and data for all existing material circumstances about which a rebid may be made imposes a significant compliance burden on generators. As does requiring a statement of the reasons as to why a rebid may have been submitted.

Complying with these requirements could increase the time required to submit a rebid potentially leading to sub optimal spot market outcomes. In addition generators may adopt more conservative bidding strategies to minimise rebidding. Costs associated with sub optimal spot market outcomes and higher compliance costs will be reflected in the contract market and ultimately consumers will bear the cost.

The current rebidding rules require a rebid to be made in good faith³ measured as the genuine intention to honour a bid. Origin considers the Federal Court decision based on having a genuine intention to honour a bid is appropriate threshold for rebidding in the NEM. Assuming guilt or requiring a generator to demonstrate innocence of bidding in bad faith is a high threshold for the NEM.⁴

The proponents rule change is similar in intent and prescription as the National Electricity Code Administrators (NECA) 2002 changes to bidding and rebidding rule change request. The Australian Competition and Consumer Commission (ACCC) determined to not progress the request and rejected the proposal. Origin considers the AEMC should reach the same conclusions as the ACCC and not progress the proposal further.

The attached submission is outlined as followed:

1. The design of the NEM
 - 1.1 The role of pre-dispatch and dispatch
 - 1.2 The impact on efficient market outcomes
2. Practical and operational implications
3. No legal basis for the proposal

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.

Yours sincerely,



Steve Reid
Manager - Wholesale Regulatory Policy
Energy Risk Management
steve.reid@originenergy.com.au

² AER 2014, 'Quarterly Compliance Report, January - March 2014, May 2014, Melbourne. p. 11.

³ The NEM operates under the National Electricity Law that outlines the functional requirements for participating in the market.

1. The design of the NEM

The nature of electricity markets are unique as supply and demand is balanced and continuously met overtime. The implication for the design of the NEM is there is an ongoing auction of supply from generators to market customers where generators are able to compete and rebid in response to changing circumstances. The market, however, is required to settle: it cannot facilitate competition and rebidding in perpetuity. The NEM was designed to facilitate competitive rebidding through every five minute dispatch interval over half an hour with the settlement based on the average of the prior six dispatch intervals.

Origin supports the current NEM design and considers there is adequate balance between facilitating competition and determining a settlement period. We do not support aligning dispatch and trading intervals. The NEM design cannot facilitate perfect competition within a trading interval and there is a reduction in the ability of generators to respond to a change in circumstances the closer to the end of a trading interval.

This is not a market failure and the proponents have not provided evidence that there is a material problem that needs to be addressed. It is not even clear that it would be desirable to impose rules to restrict generator rebidding up to the last dispatch interval of a trading interval in an attempt to prevent strategic bidding.

Professor Jeffery Borland from the University of Melbourne outlined principles for determining efficiency in the NEM. The thesis propositioned that the extent to which it would be desirable to regulate rebidding depends on the perceived efficiency gains from doing so against the efficiency losses from increasing the compliance burden on generators.⁵ Would it be efficient, for example, to restrict rebidding - to minimise price volatility or market risk - if it resulted in losses in productive efficiency for all generators operating in the market?

Origin considers instances of strategic bidding to be transient in nature and limited to specific case by case examples. Imposing bidding restrictions on all generators operating in the NEM at all times is a disproportionate response given strategic bidding is infrequent compared to the operation of the NEM as a whole. The proposal could, therefore, lead to losses in productive efficiency through an increase in compliance costs and conservative bidding resulting in inefficient spot and contract market outcomes compared to any pricing impact from strategic bidding.

1.1 The role of pre-dispatch and dispatch

Origin does not support the proposition and rationale of the proponents in defining the purpose of the bidding in good faith provisions and requesting the rule change. The proponents noted the rebidding provisions were imposed to provide generators with the flexibility necessary to adjust a position in response to unexpected changes in the market and to provide market participants that rely on pre-dispatch forecasts with an assurance that generators intend to honour initial bids.⁶ Pre-dispatch is only intended as a guide to assist participants with managing operations - generators are not responsible for the commercial outcomes of market participants that rely on pre-dispatch forecasts.⁷

⁵ Jeffery Borland, 'Bidding in good faith rule change request - presentation to AEMC forum,' 5 May 2014, Melbourne.

⁶ Government of South Australia 2013, 'Rule Change Request, Bidding in Good Faith Provisions, November 2013, Adelaide. p. 1.

⁷ Ibid. p. 7.

The AEMC Reliability Panel has noted that pre-dispatch has been working well as an indicator of reliability and security.⁸ There is no indication or expectation that pre-dispatch should be used as a forecast to base firm commercial decisions around. Dispatch outcomes are inherently different to pre-dispatch forecasts with the Reliability Panel commenting:

...perfect alignment between dispatch and pre-dispatch outcomes cannot be expected as the dispatch process utilises more complex constraint equations and real-time information whereas pre-dispatch uses less complex constraints and approximation of some terms in those equations.⁹

There are a range of real-time variables that could impact the accuracy and alignment of dispatch and pre-dispatch including:

- Demand forecasts
- Generator availability
- Network outages
- Forecasting wind
- Forecasting solar PV
- Forecasting unscheduled demand response
- Forecasting non-scheduled embedded generation

As an indicator of the difficulty in aligning pre-dispatch with dispatch, AEMO has indemnified itself from any differences between actual load and load forecasts as it has no direct influence over market participants.¹⁰ Other factors impacting dispatch outcomes are also inherently difficult to predict, especially renewable generation based on wind and solar conditions that impact market outcomes in addition to generator rebidding.

The Demand Response Mechanism and the AEMO Small Generator Aggregator scheme were identified as potential beneficiaries of the proponents rule change proposal.¹¹ Origin considers it to be the antithesis of an open and competitive market to impose restrictive regulation on particular market participants and generation technologies¹² to support another class of market participant.

1.2 Impact on efficient outcomes

The NEM matches supply and demand in real time. The 5 minute dispatch process for the energy market facilitates competition and allows generators the flexibility to respond to changing circumstances at regular intervals supported by ancillary service markets within this time. Ensuring efficient outcomes necessitates generators or loads being able to respond to changing circumstances to attempt to align market outcomes with commercial intentions. Being able to respond to changing plant and fuel conditions is also critical to optimise plant dispatch and the opportunity cost of fuel.

⁸ AEMC Reliability Panel 2014, 'Annual Market Performance Review 2013, Final Report, 7 May 2014, Sydney. p. 42.

⁹ Ibid. p. 41.

¹⁰ NER clause 4.9.1(g)

¹¹ Government of South Australia 2013. p. 7-8.

¹² Bidding restrictions are likely to disproportionately impact intermediate and peaking generation given the location on the supply curve and location on the bid stack.

Rebidding is critical to efficiently operate in the NEM to optimise dispatch and spot market outcomes. Rebidding enables a generator to efficiently respond to changes in plant conditions, fuel sources and commercial circumstances to minimise the impact of any changes in circumstances that could lead to inefficient outcomes for a generator and the market as a whole.

Inefficient spot market outcomes and losses in productive efficiency will increase the longer the circumstance is not rectified by a rebid to change dispatch levels. The continual balancing of supply and demand will impact spot market outcomes or the cost of ancillary services where a generator is unable to respond to circumstances in a timely manner. Imposing compliance obligations that restrict generator rebidding - the ability to respond to circumstances - is, therefore, inherently inefficient and increases the market risk for generators operating in the market.

Increasing the regulatory obligation for generators could result in more conservative bidding strategies to ensure compliance. This imposes a direct cost to generators to comply but has indirect costs where an increase in risks or the ability to manage risks results in more conservative hedging strategies by generators or an increase in hedging costs where the increased risk is reflected in higher premiums. Ultimately consumers would be exposed to higher electricity prices.

2. Practical and operational implications

The proponents propose a significant increase in the regulatory and compliance burden on generators that could be expected to significantly decrease the number and timing of rebids leading to a direct reduction in efficiency and increase in costs for generators. A larger regulatory and compliance burden reduces a generators ability to flexibility and efficiently respond to a change in circumstance due to the increase in risks associated with rebidding. This exposes a generator to a direct increase in costs. The proposal is unjustifiable and a disproportionate response to case specific issues of strategic bidding by generators.

Origin has developed a positive compliance culture. The success of Origin's operational and cultural measures can be measured against the AER's own criteria where under the 'three strike' policy Origin has not received a strike since June 2011. Based on Origin submitting 40,000 bids and rebids per year this equates to 120,000 bids and rebids without an infringement. The number of rebids reviewed by the AER for the NEM as a whole has declined significantly since reporting commenced in 2010 with an increase in the number of market participants self-reporting to the AER over this period.¹³

Origin traders undergo rigorous training and ongoing cultural reinforcement regarding the good faith provisions under the rebidding rules. This training directly links the good faith provisions with having a genuine intention to honour a rebid. In addition to trader training, Origin has taken additional steps to maintain compliance with rule obligations including: implementing IT systems logic to ensure all required information is provided in a bid or rebid; and all bids and rebids undergo a manual check for approval.

The proponents have not identified a compliance problem with generators adhering to rules requirements. Current obligations under NER clause 3.8.22A require generators to provide a brief, verifiable and specific reason with each rebid. In a practical sense, this requires traders to:

¹³ AER 2014. p. 11.

- Document the reason for the rebid to enable the AER to verify the reason for the rebid; and
- Provide a reason for undertaking the rebid.

The proponents rule change proposal increases the compliance obligation to rebid and change the dispatch level of a generating unit:

- Accurate and complete data and information to substantiate each rebid must be provided;
- A generator must provide a statement of the reason(s) for the rebid.
- A generator must not vary a bid unless it is in response to a 'significant and quantifiable' change.
- The generator may have contravened the good faith provisions after the knowledge, belief or intention of the generator has been considered by the AER;

Individually these changes do not appear to constitute a significant compliance burden for generators. The sum of these requirements, however, impose an increase in the number of actions undertaken by the trader before making a rebid. If there is a change in market circumstances, for example, what constitutes a significant and quantifiable change? What would constitute accurate and complete data and information? How long and detailed should a statement be given a rebid could be expected to be required within 5 minutes?

These problems are compounded for the trader where the AER may consider whether the rebid contravened the good faith provisions based on something as broad as the knowledge, belief and intention of the trader is considered.

Generators use a range of information and data to inform a decision to rebid. Information can be publically provided by AEMO or other software providers and government bodies relating to demand, generator dispatch levels and availability, interconnector flows and limits, networks constraints, outages and weather. In contrast privately business information may relate to plant and fuel conditions and forecasts to trading positions.

Origin has a large and diverse generation and retail portfolio across mainland NEM regions and commodity markets. The intention and expectation of a rebid could, therefore, reflect a trade off between changing a hedging position in one region with fuel availability in another or arbitrage opportunities between electricity and other commodity markets. Any single or combination of factors may inform a decision to rebid and the timing of the rebid. This complicates the rule change proposal as a significant or material change may involve a combination of factors. The timing of the rebid could also depend on the opportunity cost of fuel availability across commodity markets.

Providing accurate and complete data and information

Generators are currently required to retain data and information to comply with an existing requirement to verify the reason for a rebid. The proposal increases the compliance obligation from retaining information to enable the AER to verify a rebid to require generators to retain accurate and complete data and information relating to all circumstances informing the decision to rebid.

This imposes a significant increase in the regulatory requirement for a trader to comply with when rebidding in response to a change in circumstance. To ensure compliance with the proposal it could reasonably be expected that a third person be required to verify the data and information used to justify a rebid - consistent with existing Origin bidding controls - before submission further increasing the compliance burden for generators.

Origin submits over 40,000 bids and rebids each year. Over peak demand periods there is a significant increase in the number of rebids to enable generators to respond to emerging volatility in the spot market. During the extreme conditions experienced in Victoria and South Australia over the last week in January 2014 Origin submitted an average 117 rebids each day. This enabled Origin to respond to volatility in the NEM allowing efficient spot prices through competitive rebidding given the high to extreme demand levels recorded.

It could be expected that under the proponents proposal Origin would have not been able to respond as effectively to spot market volatility and other changes in circumstances. This could have resulted in an increase in spot market volatility leading to less efficient prices. Bidding restrictions would not have been in the long term interest of consumers where inefficient spot market outcomes over peak demand periods eventuated.

Given the proponent has not identified a failure under the current requirement to retain data and information to verify the reason for a rebid it is difficult to justify a requirement to retain accurate and complete data and information relating to all circumstances at the time of change in circumstance.

Providing a statement of reason

The proponents have proposed to increase the regulatory requirement and compliance obligation under the rebidding rules from providing a rebid reason to providing a statement of reasons. The proponents have not demonstrated a failure or inadequacy with the existing requirements to justify requiring generators to provide a statement supporting a rebid. The AER has also indicated that it has no intention to alter the rebidding protocol established under the Rebidding and technical parameters guideline.¹⁴

The proposal imposes a significant increase in compliance obligation on traders that could lead to inefficiencies in dispatch and spot market outcomes when generators adopt more conservative bidding strategies. These inefficiencies could be passed through in the form of higher prices in the spot and contract market and ultimately onto consumers

Providing a statement compared to a reason imposes a compliance obligation on traders that could slow the response time to a change in circumstances. Based on changes to AEMO's rebidding program the increase in requirements could be expected to be significant and onerous.¹⁵ To ensure compliance with the regulation a third person would be required to verify the statement, consistent with Origin bidding controls, before the bid could be lodged imposing a direct cost on generators.

Significant and quantifiable change

The requirement to only rebid in response to a significant and quantifiable change is inherently problematic. An insignificant change in spot price could trigger a cap or swap strike price and significantly change the trading position of the generator or, for a vertically integrated retailer, a small increase or decrease in price could have a large and significant impact when considered across the portfolio.

Some significant changes in the market are also due to the combination of minor changes. The performance of some network constraint, for example around

¹⁴ AER 2014. p. 12.

¹⁵ Based on a request from the AER, AEMO will increase the number of characters for a rebid from 64 to 300 characters.

interconnectors, can perform differently when occurring at the same time as another network outage resulting in a significant market outcome.

The bid stack consists of various tranches of generation at bids steps. Consequently, an increase in demand can be accommodated within a generator bid step without any consequential change in price. Small incremental changes in demand can, therefore, infer where demand is being met on a bid step and any pricing outcome the may occur from demand pushing through the bid step and raising further up the bid stack.

Knowledge, belief and intention

The proponents do not agree with the judgement in the Federal Court that a trader's subjective expectation of the effect of a rebid was treated as part of a material condition on which the rebid was based.¹⁶ This view appears based on an assumption that the NEM operates on an objective, pre-determined basis and that conditions and circumstances should not only be known but be taken into account when submitting an original bid.¹⁷

The intention of a bid, however, may not be realised when a trader's subjective expectations are not met: comparable to the misalignment between pre-dispatch and dispatch. A trader's intention and subjective expectations including when no significant change in circumstances has occurred is not only valid but critical to facilitating the efficient dispatch of generation. A rebid may not achieve the intent or expectation of a trader and a subsequent rebid is required. This should not be inferred as the trader did not have a genuine intention to honour the rebid but merely the intention of the rebid was not achieved in the first instance.

Market outcomes are a function of the intersection of a large number of variables. Interpreting any change in circumstances is, therefore, inherently subjective based on the knowledge, belief and expectation of the trader. The intention of a rebid may or may not be fulfilled based on a single rebid due to any combination of circumstances. A subsequent rebid may be required irrespective of the changes in circumstances.

To comply with the proponents rule change, a generator would be required to commit a predetermined number of generating units in advance: locking in the operating and maintenance costs; and gas fuel costs for committing the units. This is an inefficient and sub-optimal outcome for the generator and market as a whole where rules are imposed restricting a generator progressively dispatching units until the intended outcome is achieved.

Consider the following scenario: committing a peaking plant in NSW with four units for an afternoon peak.

- It is expected to reach 35 degrees;
- There is a high level of available generation; and
- Prices are forecast to be \$10 above the swap strike price and below the cap strike price.

Intention: protect the retail position in the market in the NSW and consider position in Queensland and Victoria.

¹⁶ Government of South Australia. p. 8

¹⁷ Ibid. p. 9.

At 14:00 demand and prices are moderate but not high. A generating unit in Victoria becomes unavailable at 14:00 so a trader decides to commit two units from 14:00 - 17:30 in NSW.

Following the rebid:

- Demand is trending slightly above forecast in NSW, Qld and Vic and prices have not been impacted by rebidding the two units:
 - Circumstances have not changed significantly and the trader's expectations for the initial rebid have not been met.
- The trader rebids a third unit from 15:00 - 17:00
 - Under the proposal this would not be possible.

At 15:00 the temperature in western Sydney increases from 35 to 37 degrees and demand in NSW increases from 12,500MW to 12,700MW (is this significant).

- The spot prices following the third unit being rebid remain unchanged due to the increase in demand.
 - Circumstances have not changed significantly and the trader's expectations for the rebid have not been met.
- The trader rebids the fourth unit at 15:30 to 18:00.
 - Under the proposal this would not be possible.

The impact of the fourth unit has reduced the spot price to by \$5 in NSW with smaller reduction in Qld and Vic. This represents a significant exposure for the generator due to the retail exposure and hedging requirements that the rebidding has been able to reduce. Events leading up to the afternoon peak could not have been forecast and through-out the afternoon peak much of the published information remained unchanged. Having the flexibility to rebid produced a significant efficiency gain for the generator and the market.

3. No legal basis for proposal

Origin supports the determination of the Australian Competition and Consumer Commission (ACCC) in rejecting the NECA changes to bidding and rebidding rules proposal in 2002. The legal implication of the proponent's rule change proposal is disproportionate to any identified problem of strategic bidding. Combined the proponent's rule change is unworkable in practice and should be rejected consistent with the 2002 ACCC determination.

In summarising the proponent's rule change request the ACCC commented:

The rule change request proposes to the good faith provision that would reverse the onus of proof from the AER onto generators to demonstrate what material circumstances had changed as the basis for their rebid.¹⁸

The proponents and the AER rejected the interpretation of the proposal as a reverse onus of proof at an AEMC stakeholder forum, however, the drafting of proposal casts the onus of proof in the negative suggesting a generator could be required to prove innocence of not bidding in good faith with a rebid:

...taken not to be made in good faith unless, at the time of making such an offer, bid or rebid, a Scheduled Generator...has a genuine intention to honour that

¹⁸ AEMC 2014. p. ii.

*offer...if the material circumstances upon which the offer...was based remain unchanged....*¹⁹

In arguing the proposal does not constitute a reverse onus of proof is a similar position to NECA in the 2002 ACCC determination.²⁰ What it does do is require a generator to prove innocence of a lack of guilt rather than have the AER built a case to demonstrate a generator did not have a genuine intention to honour a bid.

Origin recognises there is a legal precedent for a reverse onus of proof where cases may be difficult to prosecute or where there is a public benefit from doing so. The ACCC determination assessed whether provisions relating to misleading and deceptive conduct under the former Trade Practices Act or bad faith were applicable to rebidding. A submission to the 2002 process noted that the reverse onus of proof was not a legal burden of proof but related to evidence that someone could demonstrate a reason for making a claim that was not intended to deceive.²¹

The current rules require a generator to provide a reason for making a rebid and for the generator to have a genuine intention to honour the rebid. The Federal Court ruled a trader's subjective expectation and intention after interpreting all information relating to circumstances was a valid reason for a rebid. Origin does not consider the proponents have demonstrated a public benefit to require a generator to prove innocence of lack of guilt and, consistent with the ACCC 2002 determination, the proposal should be rejected.

¹⁹ Proposed changes to NER clause 3.8.22A(b)

²⁰ ACCC 2002. p. 12.

²¹ Ibid. p. 21.