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Authorisation of Changes to the Rebidding Rules Contained in the National Electricity Code (Authorisation numbers A90797, A90798 and A90799)

Dear Michael,

Origin Energy Electricity Limited (Origin) welcomes the opportunity to comment on the above code changes. Origin is a vertically integrated energy company with a major gas and electricity retail position throughout Australia.

General comments

Origin is concerned that the proposed code changes will impinge on competition in the National Electricity Market while increasing both compliance costs and charges for end users. Despite claims by NECA that these code changes are not about high prices, it is our view that NECA is attempting to impose a particular market outcome of lower prices. **The code changes are aimed at delivering a specific price outcome.**

Origin has previously submitted to the Commission that the guidelines mentioned in the proposed code changes be codified in our letter dated 9th October 2001 and once again requests that the Commission not authorise any code changes where the guidelines that govern their operation are outside of the Code.

In Origin's opinion, the proposed code changes will create an unworkable framework for market participants.

It is our belief that the proposed code changes will:

- Reduce Competition in the National Electricity Market.
- Impact negatively on supply security and reliability.
- Create a high level on confusion as to what is appropriate behaviour within the NEM.
- Provide NECA with an increased ability to interfere with the operation of a competitive market.
- Have the effect of materially prejudicing the operation of the market.
- Impose a higher level of anti competitive monitoring than that imposed by the Federal Government via the Trade Practices Act 1974.
- Conflict with the National Electricity Code objectives and sections 3.1.4(b) and 8.3.5(g).

The proposed code changes that relate to the bidding of energy into the National Electricity Market by generators are retrospective in structure. That is, they rely on the interpretation by outside parties of what was intended by the participant at the time of the bid. The danger of these code changes is that a participant may be unfairly held accountable for a particular effect or market outcome when this outcome was not the result of an individual action but rather the result of the interaction of many competitive bids, a fluctuating level of demand, the setting by NEMMCO of the pool price and maintenance of system security, fluctuating levels of service by the TNSPs and a range of state based derogation which cause numerous distortions in the market.

To look back retrospectively and hold accountable a particular participant for a market outcome is not only impractical but also likely to be unprovable. Market participants need to operate in a competitive, transparent and clearly codified market. The NECA proposals impact the supply security of the market and will likely lead to higher prices as participants shy away from competitive bidding for fear that after the event they may be accused of acting inappropriately and not be able to defend their actions under the proposed reversal to the onus of proof.

Origin believes that the code changes are in conflict with the intentions of the Trade Practices Act to promote competition by creating a barrier to competition and attempting to impose a higher level of scrutiny on the actions of participants than that intended by s46 of the TPA. We request that the Commission do not authorise the proposed code changes in their current form and further recommend to NECA that any code changes should not be directed at reducing competition.

Proposed Code Changes

Origin has many specific concerns with the proposed code changes.

3.8.22(c)(3)

*NECA must publish the guidelines developed under this clause 3.8.22 **and may amend such guidelines from time to time***

As previously stated to the Commission Origin believes that it is untenable that any guidelines that act to interpret the operation of the proposed code changes should fall outside of the code. NECA is the code administrator, not an overseer and standard setter of appropriate market behaviour and we request that the Commission not grant NECA such powers and to require that any guidelines be codified so as to protect the rights of both market participants and end use customers. This code changes will give NECA the ability to modify the guidelines without consultation with market participants.

3.8.22A(b)

In any proceedings for a breach of clause 3.8.22A(a), a Market Participant is deemed to have contravened clause 3.8.22A(a) unless the Market Participant satisfies the Tribunal that the dispatch offer, network dispatch offer, dispatch bid or rebid was made in good faith.

As mentioned previously Origin believes that the reversing of the onus of proof is unworkable. In the next section I have highlighted that NECA's focus is not on intent exclusively, but also on "effect". The resulting impact is that a participant may never be able to prove after the event that the resulting effect was not intended. This places market participants in an untenable position. Reversing the onus of proof is only effective when the resulting outcome is exclusively the result of an individual action.

When a generator makes the decision to turn off a unit for some maintenance when prices are low without knowing that another company is about to turn off a unit as well, the resulting impact may be greater on prices than expected however certainly was not intended.

3.8.22B(a)

*A Market participant must not submit a dispatch bid, network dispatch offer, dispatch offer or rebid, if such conduct has the purpose, or **has or is likely to have the effect** of **materially prejudicing** the efficient, competitive or reliable operation of the market in accordance with the market objectives and the purpose of the market rules as set out in clause 3.1.2 unless the Market Participant has **reasonable** cause for the dispatch bid, network dispatch offer, dispatch offer or,*

As indicated above Origin has great concerns with the words, “likely to have the effect”. It is our view that by including these words this clause captures those actions by a participant where there was no purpose to impact upon the market outcome. As previously explained many factors and actions lead to a particular market outcome. Origin has several concerns with this approach:

- A Participant may have no choice regarding a particular action i.e. turning a unit off or reducing dispatch so as to protect the mechanical life or safety of a specific unit, yet other events may give the appearance that this participant had the effect of impacting the market. Although a participant is allowed reasonable cause, what may be seen as reasonable cause at the time may be interpreted differently by NECA after the event. And with the reversal in the onus of proof this participant may be exposed.
- This is a strict test, and thus a participant may materially impact on the market even where this was not the intent, however after the event a participant may have no way of proving otherwise under clause 3.8.22A. Effectively what is intended has no relevance only what actually happens.
- This clause is unclear about what behaviour it is trying to limit, i.e. pushing prices higher, which is not illegal of itself under the TPA or taking advantage of changed market conditions of supply and demand which of itself is simply proof of competition.

Origin would recommend that a better approach would be for NECA to define what behaviour is inappropriate based on specific actions not based on the end results. **It is not reasonable or in fact practical to focus on effect rather than actions.**

3.9.22B(b)

..... Any guidelines issued by NECA under this clause 3.8.22B(b) **are indicative only**, not legally binding upon NECA and do not affect the legal scope of clause 3.8.22B9(a),

Market participants need certainty in operating within the code rules, not indicative, constantly changing guidelines. Only certainty will give investors the stable environment in which they will continue to invest in the NEM so as to ensure supply security and value for the end users.

Section 3.11.3(b)

*NEMMCO must develop and publish a procedure for determining the quantity of each kind of non-market ancillary service required for NEMMCO to achieve the power system security and reliability standards and to **enhance the value of spot market trading***

NEMMCO is the market operator, within a defined set of rules they are responsible for setting the market pool price, signalling generator despatch and for maintaining a secure electrical system. Market participants operate within this framework so as to maximise their value as would be expected in any industry. The Code needs to be clear and defined and not create a vague undefined framework. Origin asks the Commission to request from NECA that a clear set of rules be established so as to define the actions of NEMMCO so as to remove any discretion from their actions and so as to increase certainty for Market participants.

Section 4.2.6 (b)

...NEMMCO should take all reasonable actions to adjust wherever possible, the operating conditions with a view to returning the power system to a secure operating state ~~as soon as practical to do so, and in any event,~~ within at most thirty minutes.

The proposal to remove the words "as soon as practical to do so" places an inappropriate financial decision making process in the hands of NEMMCO while placing at risk the system security of the NEM.

The defined operational ratings of various inter-connectors are principally set so as to manage possible contingency events, such as units tripping or unexpected sudden demand increases. Once an initial contingency event occurs the risk to the market security if a second event occurs is increased dramatically. Therefore it is important for system security that any contingency event be resolved promptly. The NECA proposal would increase

the risk that a second contingency event would result in supply security problems. It is hoped that jurisdictions would not be happy with a procedure that increases the chances of blackouts so as to decrease some occasions of higher prices, that may result from not returning the power system to a secure operating state as soon as possible.

NEMMCO is the market operator whose role is to apply the rules of the Code and manage the physical operation of the market. It is therefore important that all NEMMCO decisions are based on a known set of rules so as to give both market participants and NEMMCO certainty about the manner in which the market should operate. The NECA code change proposals will force NEMMCO to make a system security versus price trade off. It is not appropriate for NEMMCO to have to make such a decision, nor are there any guidelines as to how NEMMCO would apply such a methodology.

NECA would be better served to focus their attention on the operational standards of the TNSPs. The TNSP must be more accountable for the operation of the various inter-connectors and carry some financial exposure/liability as an incentive towards increased reliability and availability. The TNSP must have incentives to offer firm capacity over inter-connectors at times of high market stress or demand.

We request that the Commission does not approve the creation of discretionary financial powers for NEMMCO which may result in a greater likelihood of load shedding to the detriment of end users.

Other Issues

Reduction of Competition in the National Electricity Market.

NECA expresses concern about "short term price spikes not representing genuine price signals". We are concerned that such statements may indicate a lack of understanding by NECA of the true competitive nature of the NEM and the importance of such price signals. Market power can only exist for as long as it takes someone else (a competitor) to react. Clearly in the NEM the ability of another generator to react to a price signal and bid more load into the market is an appropriate signal and a sign that the market is working in a competitive way. In fact it has been these very price signals that have led to the investment in a significant quantity of new generation in the NEM. Price volatility has increased competition not only in the short

term (real time) but also in the long term by acting as an investment signal.

On the 24th of May 2001 NECA published a paper titled "Bidding and rebidding strategies and their effect on prices Issues paper." In this paper NECA states on page 1 that:

*"Moreover, comparisons of forecast prices based on initial bids suggest that **rebidding leads overall to lower prices** than would otherwise have been the case."*

In fact NECA's analysis showed that for the past summer rebidding actually resulted in significantly lower prices as seen in **Table 1** below:

Region	Volume Weighted Average Price		Difference
	Actual	Forecast based on initial bids	
Qld	\$47.38	\$76.71	-38%
NSW	\$40.53	\$45.16	-10%
Vic	\$54.94	\$58.65	-6%
SA	\$82.36	\$95.80	-14%

Table 1

Page 16 NECA Bidding and rebidding strategies and their effect on prices Issues paper 24/5/01.

The market prices act effectively as a capacity mechanism signalling new investment where required. It is important that NECA and the Code does not act to suppress the very price signals that ensure the supply security of the market. The actions of market participants to rebid whether it be to lower or higher price bands is not of itself illegal or in breach of the Trade Practices Act (TPA)

Section 46 of the TPA prohibits a corporation that has a substantial degree of market power from taking advantage of that power for prescribed anti-competitive purposes, namely:

- Eliminating or substantially damaging a competitor;
- Preventing the entry of a person into any market;
- Deterring or preventing a person from engaging in competitive conduct in any market.

While, at first instance, generators are subject to section 46, the section is not likely to apply to generators who rebid in accordance with the Code. This is because section 46 is limited in its scope. It requires the misuse of market power to be in respect of one of the three prescribed purposes listed above. Rebidding, however, even for the purpose of increasing prices solely for financial gain, is not likely to fall within one of these three prescribed purposes. Section 46 does not in general terms prohibit parties with market power from influencing the price.

A useful analogy is the airlines industry where high fares led to the introduction of new competitors, or the telecommunications industry where new entrants rushed to provide cheaper services in competition to the incumbent players. It is a dangerous precedent to allow NECA to apply a different standard to the NEM than that applied to other industries.

Origin believes NECA is incorrect when it purports on page 2 of its submission that the high price spikes:

"Have no basis in the underlying dynamics of the market"

It is clear that not only is rebidding essential to the market as the most transparent competitive market mechanism but it essential in ensuring the supply security for end use customers.

Origin believes that the code changes will reduce real time competition in the National Electricity Market.

Impact negatively on supply security and reliability.

The change to the NEMMCO code based guidelines removing their requirement to bring the system back into a secure operating state as soon as practical to do so, coupled with a retrospective NECA judgement process on market participants, will most likely influence prices, the available short term supply, new investment, and bidding behaviour. Despite the NEM being only three years old it has made giant strides in signalling new investment and promoting more efficient energy consumption. The Commission must not allow code changes to be authorised that would deter new investment, reduce competitive bidding and allow the market operator to inappropriately influence prices.

NECA admits on page 6 of it submission to the Commission that;

"NECA agrees with NEMMCO however that any change to the safety margin or the 30-minute maximum recovery time would require further consultation and the need for revised guidelines"

However;

"NECA does not believe, however that it is necessary or sensible to delay the first stage of these improvements until those guidelines are developed"

Origin believes the Commission should not accept such a compromise. Clarity in the rules that govern the market operation and the actions of NEMMCO are crucial in ensuring market security, supply security and competition.

Conflicts with the National Electricity Code sections 3.1.4(b) and 8.3.5.

While it is expected that the NEC will require revisions, it is presumed that those changes will be clear and in line with current market objectives.

Section 1.3(b) of the National Electricity Code states as a market objective that:

"The market should be competitive"

Section 1.4(b)(1) of the code then states that the objective of the code is:

"To provide a regime of "light-handed" regulation of the market to achieve the market objectives;"

The proposed code changes are heavy handed, will increase compliance costs, and will require participants to explain the actions of their competitors when explaining particular price effects in the market. The Commission must support competition in the market. The National Electricity Market has not failed. It has delivered new competitive supply to meet growing demand and NECA own analysis has shown that rebidding as a competitive mechanism has resulted in lower prices.

The proposed NECA code changes do not promote competition and are clearly not light handed. They impose a significantly high level of retrospective scrutiny on participant's behaviour where participants will be presumed to be guilty until proven innocent.

Section 3.1.4(b) of the NEC states that:

These market rules are not intended to regulate anti-competitive behaviour by Market Participants which, as in all other markets, is subject to the relevant provisions of the Trade Practices Act, 1974 and the Competition Codes of participating jurisdictions.

While this section is not all encompassing it does serve to give direction as to the focus on the code. The Federal Government has established the TPA which serves to impose a national set of rules on the Australian market as to what is appropriate competitive market behaviour; the proposed Code changes sees NECA trying to impose an alternative regime. Origin believes that this is inappropriate.

Section 8.3.5(g) of the code states that:

In formulating any recommendations, the CCP must take into consideration the market objectives and the Code objectives and seek to give maximum effect to market mechanisms where feasible.

It is our view that the proposed code changes are in conflict with this section and thus should not be authorised.

Create a high level of confusion as to what is appropriate behaviour within the NEM.

NECA makes several assertions in their paper supporting these code changes. They claim on page 3 that they are attempting to prohibit bids that are "objectionable". NECA offers no clear explanation as to what this means or "objectionable to whom".

It is also claimed on page 3 that NECA is attempting to;

"Further strengthen the information disclosure obligations surrounding rebidding to ensure that the reasons for rebids are authorised at an appropriate level"

This comment sees NECA trying to impose an unclear risks management process upon market participants. This is clearly not the role for NECA and the Commission should not support the development of such a role.

On page 10 of the submission NECA indicates that it is seeking to prohibit bids that;

*"Are likely to have the effect of **materially** prejudicing the **efficient, competitive** or **reliable** operation of the market."*

This test is not clearly defined and introduces a level of subjective judgement that, in Origin's view, is unacceptable as proposed. The Commission should not authorise code changes that would see market participants held accountable for competitive behaviour that breaches undefined terms on a retrospective basis.

Conclusion

Origin does not believe that the proposed code changes are in the interest of the NEM. We believe that they conflict with the TPA, contradict the code objectives, and inappropriately extend the role of NECA while creating an unworkable set of market rules. We are concerned that the code changes are directed at delivering a specific price outcome rather than creating a competitive and reliable market.

Of greatest concern to Origin is how these code changes will impact on our ability to deliver an efficiently and competitively priced product to our customers while ensuring a constantly improving level of supply security.

The greatest single impact of the proposed code changes will be a change in the bidding of generators from real time constant rebidding to support previously sold financial products, to a more conservative bidding behaviour. This will occur, as generators will be held accountable for a market outcome "effect" rather than a specific action of the participant. This will result in generators bidding in load at higher prices ahead of time and unlike the evidence shown by NECA actual prices will not differ significantly from forecast prices. The most serious impact of this behaviour will be the offering of fewer financial contracts or contracts at higher prices. This will see costs for end users rise or if fewer contract are available then a significant drop in retail competition.

The proposal by NECA not to codify the guidelines to be used to interpret these code changes further increases our concern regarding the operability of the Code under such circumstances. We must state our strongest resistance to the proposal to establish a market surveillance and monitoring committee without any input from the market participants.



Origin requests that the Commission acts to support the competitive integrity of the NEM by not authorising the proposed code changes.

If you have any question regarding this submission please do not hesitate to contact the undersigned.

Yours sincerely

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