NATIONAL GENERATORS FORUM

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Dr. John Tamblyn
Chairman
Australian Energy Market Commission
Level 16, 1 Margaret Street
SYDNEY NSW 2000

Dear Dr. Tamblyn,

Consultation on technical standards

The National Generators Forum (NGF) has number of serious concerns that relate to the current AEMC review, as directed by the MCE, of "Enforcement of, and compliance with, the technical standards under the National Electricity Rules.

While this review is the occasion for our letter, the concerns that we will summarise have developed over a substantial time and evolved independently among our members. These concerns, which are outlined further in the attached document, demonstrate that the current technical standards affecting generators are not in a state where total compliance with them is feasible. Furthermore, the current design of these standards is not consistent with the objectives of the National Electricity Market (NEM).

As a consequence, we believe that this review should not proceed until the standards against which compliance is to be measured are in a more robust form. Otherwise, the compliance regime will be flawed and based on foundations that are faulty or missing.

It should be noted that the NGF and each of its members support the use of technical standards as a means to achieving NEM objectives, including the emphasis on reliability and security of supply in the electricity system that the technical standards should be designed to promote.

We believe that AEMC should ensure that an appropriate set of technical standards is established upon which a compliance regime can then be implemented. To this end we have prepared the attached overview of our concerns in regard to the current regime. The attached document is not intended as a full response to the issues in the AEMC issues paper, but rather a small selection of the broader issues in relation to technical standards

which have convinced us of the need to review the current position before moving forward on compliance.

I look forward to your positive response in regard to these matters and their implications for the current review. The NGF seeks the opportunity to discuss this with you in the near future.

Yours faithfully,

John Boshier
Executive Director

ENFORCEMENT OF, AND COMPLIANCE WITH, THE TECHNICAL STANDARDS UNDER THE NATIONAL ELECTRICITY RULES.

SUBMISSION FROM THE NATIONAL GENERATORS FORUM

EXECUTIVE SUMMARY

The NGF has a number of concerns in regard to the application of a compliance regime on technical standards, when the substantive technical standards themselves are, in our view, not compliant with the objectives of the NEM, are deficient in fundamental ways and in some cases are infeasible for generators to comply with at a practical level.

The key areas where these concerns exist are as follows:

- Drafting of technical standards such that some requirements are impossible to meet.
- Failure of the current Market Rules to provide the grand-fathering of performance standards which was the stated intention,
- The lack of performance standards applicable to transmission network service providers,

These matters are described in greater detail below. The NGF is of the view that the development of a compliance regime at this time is not appropriate until the underlying technical standards are in a form that can provide a meaningful and practical set of criteria against which performance can be measured.

KEY AREAS OF CONCERN

1. Drafting issues leading to requirements that are impossible to meet

The NGF does not fully support the intentions of the current technical standards in the Rules. We are concerned by a lack of balance in their application to different parts of the supply chain, and by the use of compulsory acquisition of services where market mechanisms could be used.

However, even if these intentions were accepted, the current drafting cannot be accepted. The drafting fails in important ways to match the stated intentions of the standards.

These departures from the intention create unwarranted risks for generators, including some requirements that are impossible to meet.

We take as an example the technical standard dealing with cascade failure. This is arguably the most critical of all the standards relating to generators. Cascade failure refers to an event where a disturbance in the network leads to consequent failures of other equipment, potentially leading to widespread loss of supply. This issue has an inherent concept of causation, since it is only failures that are a consequence of a prior disturbance that are relevant.

The relevant technical standard does not, directly or indirectly, refer to causation. The result is that virtually any failure of a generating unit, regardless of the presence or absence of a prior disturbance, is technically a breach of the Rules.

Given that the occasional failure of a generating unit is a risk that cannot be avoided, no generator can assure compliance with this badly-drafted requirement.

2. Failure of grandfathering to achieve the stated objective

While the individual performance standards for new generating units are a matter for negotiation prior to construction, all existing generators were proposed to have existing performance "grandfathered". To quote from NECA as reported in the AEMC issues paper –

Existing plant should be able to treat its current performance as its registered performance standard.

The process defined in the Rules, as administered by NEMMCO, has generally failed to deliver this outcome. These failures include many performance standards beyond the current design performance of the plant, and also many cases where performance standards remain undefined.

We do not seek to allocate blame for this outcome, but we do say that the problems should be found and rectified, and performance standards in accordance with this stated intention should be put in place, before the issue of conformance can be properly addressed. The rules need to be clear and able to be complied with, before enforcement is considered.

We wish to emphasise the critical importance of this issue in relation to the NEM objective. There is a danger that "grandfathering" may be seen as a favour to existing generators. This is not the case, and the true issue here is one of sovereign risk.

The application of new technical standards to existing generators is wrong for much the same reasons as any retrospective legislation or regulation is likely to be wrong.

If the regulatory regime of the NEM were to allow unplanned costs to be imposed on generators because of new technical requirements, then any potential investor contemplating generator construction would have to allow for similar imposed costs in future. This would raise an additional hurdle to investment, potentially delaying investment thus worsening reliability of supply and increasing its cost, contrary to the NEM objective.

Note that it is the possibility of such cost impositions that creates the harm, and this harm would be done even if the power to impose retrospective requirement was never actually used.

The power to impose higher technical standards on existing generators is not only harmful, it is also unnecessary. Any changed requirements can be dealt with by alternatives including investment in the transmission network. In accordance with the objective of the NEM, an economic choice should be made between these alternatives, rather than using technical standards to compulsorily acquire the service. In other words, economic efficiency requires that services be acquired by commercial arrangements, not compulsory acquisition.

To achieve the NEM objective, the grandfathering of existing plant performance must be made fully effective. Related protections should also be provided to new generators against future cost impositions.

3. The existing technical standards are affected by a serious distortion

The National Electricity Rules reveal a remarkable omission. There are no performance standards for Transmission Network Service Providers (TNSPs).

Generators have performance standards, based on technical standards. Customers have technical standards, which indirectly affect Distribution Network Service Providers and also end-use customers. Market Network Service Providers have technical standards.

TNSPs, uniquely, have no performance standards in the Rules.

We note that all market participants are required to conform to system standards, including TNSPs, but these are not of the specific, detailed and enforceable nature as the technical standards and performance standards applying to generators and to market customers.

The absence of performance standards for TNSPs is not because the performance of these networks is of no consequence. All three of the events mentioned in the reference for this review had their origin in a transmission network event. We believe that in at least two of these events, the TNSP performance had a crucial role in determining the severity of the eventual outcome, and that this has not yet been adequately recognised in reports on these incidents. In each of these cases, generators have been penalised for failure to 'ride through' the failure of a network, while the networks have not, we believe, been held accountable.

We note that the AEMC does not intend to re-investigate the three incidents cited in relation to this review. We believe that the apparent bias in TNSPs being spared the application of performance standards gives good reason for the Commission to re-consider that intention. An independent review, designed to impartially analyse the respective contributions to the supply failure of networks and generators would assist in designing effective technical standards.

The lack of performance standards applicable to TNSPs has special significant to generators. This is because the requirements placed on generators include –

- Requirements for generators to withstand events originating in the transmission network, and to
- Provide services that could otherwise be provided by investment in the transmission network.

Clearly the TNSPs are not disinterested parties in relation to generator performance standards. This raises two major concerns.

Firstly, given the apparent bias in favour of TNSPs that is apparent in the setting of performance standards; we can have no confidence that a proper balance has been achieved between requirements on generators to withstand network events and requirements on TNSPs to limit the disturbances that their network events cause.

Secondly, the market rules grant the TNSPs a quasi-regulatory role in relation to the setting of performance standards for generators. This may allow them to shift costs from themselves to generators without any economic analysis and without any regulatory oversight. This ability is damaging to generators, given the monopoly position that each TNSP holds in its area.

In drawing attention to this lack of balance, we do not allege that it is by design. It is most likely an unconscious result of:
(a) the heavy involvement of TNSP personnel in developing the initial National Electricity Code and in the determination of generator performance standards, and
(b) the sourcing of many NEMMCO and NECA personnel from groups that were, or later became, TNSPs.

Regardless of the source of this lack of balance, we believe that the performance standards should be extended to cover TNSPs and all existing performance standards should be reviewed specifically to remove any possible bias. Further, the setting of any performance standard that may affect a TNSP and another connected party should be made independent of the TNSP.

OTHER OBSERVATIONS

In the notice of reference for this review, para 1.4.2 mentions "commercial advantage to generators in South Australia", while para 1.5.3 refers to the "potential for perverse incentives".

The obvious imputation is that the rectification of technical performance at the plant in question was delayed for commercial reasons. This contention appears to be the major driving force behind this review. We are concerned that these comments appear to be based on an incomplete understanding of the market.

We make the following general observations –

- The outcome regarding power flows and pricing in the relevant period was determined by action taken by NEMMCO, not the generator,
- Base-load power stations such as Northern Power Station are generally highly hedged. To the extent of such hedging the generator does **not** benefit from one-off events raising market price.
- Retailers purchasing from the NEM are generally highly hedged. To the extent of such hedging they are **not** disadvantaged by one-off events raising market price

CONCLUSIONS

We ask that the AEMC either defer this review, or fundamentally change its Terms of Reference, on the following grounds

The enforcement and compliance regime should not be altered while–

- The drafting of the technical standards in Rules is so poor, and inconsistent with stated intentions, that no generator can ensure compliance,
- The performance standards for individual units widely fail to conform to the stated intention of "grandfathering" existing performance, noting that this "grandfathering" is important in achieving the NEM objective, and was a specific outcome of the NECA Review,
- The component of the supply chain which is the major source of disturbances and the major risk of cascade failure, namely the transmission network, is excused from the performance standard regime,

- The Transmission Network Service providers are granted a quasi-regulatory role on technical standards which provides the opportunity for unexamined cost shifting onto generators and consequently excessive technical requirements on generators.

We believe that any one of these issues alone is substantial enough to warrant a change to the current review; taken together they represent an overwhelming justification for the current review to be suspended until the underlying regime of technical standards is resolved.

17 March 2006