

# ELECTRICITY TRANSMISSION NETWORK owners

## Review of Enforcement and Compliance with Technical Standards

Response to AEMC Draft Report

25 July 2006



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### 1. Background

The Electricity Network Owners Forum (ETNOF) welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC) draft report to the Ministerial Council of Energy (MCE) on enforcement and compliance with technical standards.

ETNOF notes that there are also changes to the National Electricity Rules (the Rules) before the AEMC at present sponsored by the National Electricity Market Management Company (NEMMCO), entitled "Technical Standards for Wind Generation". The NEMMCO sponsored rule changes are far reaching and, to some extent, overlap with some of the matters dealt with by the draft report. The ETNOF submission on the NEMMCO proposal supported changes required to enhance the process of registering wind farms, but strongly advocated for the other issues covered by the NEMMCO proposal to be held over and to instead be addressed as part of this and subsequent reviews.

ETNOF is also aware of the work being undertaken by the members of the National Generators Forum and NEMMCO on preparing an expedited Rule change to register the performance standards of those generators connected to the national grid at the performance standards commencement date. ETNOF supports this process and the 'grandfathering' of rights envisaged by the Rules. However, we would stress that this is a specific solution to an existing problem that predates the establishment of the Rules, and should in no way be taken as a precedent for the negotiation of performance standards for new connecting parties.

The remainder of this submission is in two parts as follows:

- Section 2 describes the overall substantive ETNOF position; and
- Section 3 provides responses to each of the AEMC recommendations in turn.

### 2. Substantive ETNOF Position

ETNOF strongly supports the overriding objective of establishing effective system security related compliance and enforcement arrangements. However, ETNOF believes a number of the AEMC's recommendations need revising to achieve the intended outcome in relation to transmission technical performance compliance and enforcement. In summary, the reasons for this are as follows:

1. NEM governance arrangements do not support an expansion of NEMMCO's compliance role. Some of the AEMC's proposals, while acknowledging the distinct roles of the Australian Energy Regulator (AER) and NEMMCO, appear inconsistent with the MCE's governance framework, particularly the proposals for expanding the role of NEMMCO into Rule compliance and enforcement. We would note that NEMMCO itself has technical Rules with which to comply.
2. The current system security related compliance processes applying to both NEMMCO and Transmission Network Service Providers (TNSPs) are effective. The current arrangements have the elements needed to achieve effective compliance by these

bodies. In particular, the requirements and obligations are clear, with an existing requirement to maintain compliance programs under the oversight of the AER. In the absence of any evidence of significant problems with the existing regime applying to TNSPs and NEMMCO, the proposed significant increase in regulatory requirements does not appear justified.

3. Arrangements for access seekers and access providers need to be differentiated. The arrangements applying to transmission network technical performance are, and should be, fundamentally different to the arrangements applying to the technical performance of access seekers. The AEMC proposal, however, envisages the same approach for the determination, compliance and enforcement of technical performance requirements for both access seekers and access providers, and ETNOF submits that this is inappropriate and needs to be revisited.
4. Proposals for the imposition of fines need to more fully recognise the different drivers on the bodies involved. For example, pecuniary fines on commercial organisations that have the potential to be motivated to deliberately breach the rules to reap windfall profits are justifiable. However, regulated entities, such as TNSPs have commercial drivers that are substantially based upon on-going regulatory compliance. TNSP directors and managers therefore do not have any incentives to deliberately breach the rules in order to make a windfall gain. There is no rationale for putting in place a higher level of penalty, such as applies to rebidding.

Each of these matters is now explained in more detail with reference to the specific AEMC recommendations that ETNOF considers need to be revised.

## **2.1 Inconsistency with Council of Australian Governments (COAG) Governance Arrangements for the NEM**

The NEM governance framework has been very clearly enunciated by COAG and the MCE. This includes clear delineation of the roles the AEMC, AER, and NEMMCO. In particular, enforcement activities (which include compliance and monitoring) were stated to be the exclusive role of the AER, while NEMMCO's role is primarily operational.

As a result, the NEM reform process to date has established new governance arrangements with the express objective of separating the rule making and enforcement roles. The Australian Energy Market Agreement (as amended in 2006) (AEMA) records the agreement of governments as to the Australian energy market institutions and the role that they will each perform. Clause 5.1 of the AEMA states:

*“The Parties agree that the Australian energy market institutions will comprise:*

- a. The AEMC, responsible for rule-making and energy market development at a national level, including in respect of the National Electricity Rules and the National Gas Rules.*
- b. The AER, responsible for economic regulation and compliance at a national level, including in respect of the Australian Energy Market Legislation.*
- c. NEMMCO, responsible for the day-to-day operation and administration of both the power system and electricity wholesale spot market in the NEM and other support activities.”*

This separation of roles was reinforced by the MCE in its August 2004 Legislative and Regulatory Framework Information Paper<sup>1</sup>.

However, AEMC recommendation 4 proposes that NEMMCO issues guidelines setting out specific requirements for generator and NSP compliance programs. Furthermore, recommendation 5 proposes that NEMMCO be responsible jointly with the AER for reviewing and approving generator and NSP compliance programs.

ETNOF considers that these recommendations will result in a lack of accountability and are contrary to the NEM governance arrangements, by giving NEMMCO an enforcement and compliance role. This approach also leaves open the question of NEMMCO's compliance with its own system security obligations under the Rules, creating possible conflicts of interest in NEMMCO being both subject to the Rules, and in a potentially privileged position by sharing an enforcement role with the AER, the Rule enforcement body.

The National Electricity Law (NEL) and Rules currently approach this issue clearly and effectively by subjecting both NEMMCO and the NSPs to compliance and enforcement oversight by the AER for any breach of the Rules. ETNOF believes that this approach is consistent with good governance principles, and should not be altered.

## **2.2 Current System Security Related Compliance Processes are Effective**

ETNOF considers that the existing compliance and enforcement framework is broadly appropriate for TNSPs and NEMMCO. That is, there is no threshold case for applying the technical performance approval process for access seekers to TNSPs.

Despite a number of system incidents and various compliance reviews by both the former National Electricity Code Administrator (NECA) and the AER, ETNOF is unaware of any material shortcomings that have been identified with either NEMMCO or TNSP compliance under the Rules. The NEMMCO reports into the incidents in NSW and South Australia, referred to in the MCE brief to the AEMC that initiated this review, do not identify issues with TNSP compliance.

In addition, concerns about the state of the registration of current performance standards of existing generators do not extend to either NEMMCO or TNSPs. Specifically, their performance and compliance obligations are mandated in the Rules and in jurisdictional instruments, such as licences and/or mandated planning standards. Importantly, unlike generators, there is no parallel process for 'negotiating' performance obligations as applies to generators.

In the event that there are concerns about the commitment of TNSPs, or NEMMCO, to ensuring that system security related obligations are being met, the existing arrangements

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<sup>1</sup> The MCE's August 2004 Legislative and Regulatory Framework Information Paper consequently stated at page 4-5 that:

*"One of the critical elements of the reform package is the reform of the electricity and gas market regulatory structures and institutional mechanisms, particularly to improve the governance arrangements that apply in relation to the Australian Energy Market. The proposed new governance arrangements entail the separation of:*

- a Policy making – which is responsibility of the MCE;*
- b Rule making and energy market development – which is to be the responsibility of the Australian Energy Market Commission (AEMC); and*
- c Economic regulation and market rule enforcement – which is to be the responsibility for the Australian energy Regulator (AER)."*

provide remedies. The AEMC's theoretical framework for effective regulation of compliance and enforcement proposes a flexible approach by the regulatory body, which, in the NEM, is the AER. Consistent with this framework, any legitimate AER concerns about TNSP, or NEMMCO, compliance could be easily addressed by the AER increasing its level of surveillance. In this regard, and given the importance of system security in the NEM, TNSPs would be prepared to submit their technical compliance programs to the AER. This could be put in place without a single Rule change, either voluntarily, or in response to a request from the AER.

ETNOF notes that some parties have suggested that the AER may not have the technical capability to fully implement technical compliance and enforcement regulation. This cannot provide justification for another party, such as NEMMCO, to absorb functions assigned to the AER in accordance with the NEM governance arrangements. Rather, the AER must develop or acquire this capability. This is necessary to enable the AER, among other things, to determine the adequacy of a TNSP's capital expenditure and operating expenditure programmes to meet service obligations and to ensure proper regulatory oversight of NEMMCO in the execution of its obligations as market and system operator.

In summary, ETNOF considers that no compelling case has been put forward by the AEMC, either on the basis of observable process failures, or in terms of enhancing the NEM Objective, for changing the compliance and enforcement arrangements currently applying to TNSPs and NEMMCO.

### **2.3 Arrangements for Access Seekers and Access Providers Need to be differentiated**

Both TNSPs and NEMMCO have a role in setting performance standards for access seekers such as generators. These responsibilities are consistent with the overriding principle of TNSPs planning, developing, operating and maintaining transmission assets in a way that delivers a reliable national transmission system capable of operation in a secure state<sup>2</sup>. This allocation of responsibilities is also consistent with NEMMCO being required to operate the national transmission system in a secure state<sup>3</sup>. Overall, there is a clear delineation between the obligations of TNSPs and NEMMCO in relation to achieving system security.

A TNSP's power system security functions and reliability responsibilities necessitate the involvement of TNSPs in the process of setting performance standards for access seekers. As such ETNOF considers the omission of TNSPs from the process contemplated by the AEMC's recommendations 1 and 2 as fundamentally flawed. It is the TNSPs, in their power system security role of planning, designing, operating and maintaining the network, that are responsible for ensuring appropriate technical performance outcomes from access seekers, having regard to the inter-relationship between technical performance by an access seeker at its connection point and the network performance achievable elsewhere on the network<sup>4</sup>.

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<sup>2</sup> The following NER provisions disclose that TNSPs are responsible for planning, developing, operating and maintaining their networks to enable the system to be operated in a secure state:

- Clauses 5.2.3(b) & 5.6.2(e) and schedule 5.1, and
- Clause 4.3.4, which sets out TNSPs' power system security obligations.

<sup>3</sup> The following NER provisions disclose that NEMMCO's power system security role is one of operating the system in a secure state:

- Clauses 4.1.1(b) & 4.3.1(a), and the Chapter 10 definition of 'power system security'
- Clause 4.3.1 which sets out NEMMCO's power system security responsibilities by reference to operational activities, see, in particular, clause 4.3.1(b), (c), (f), (g), (h))
- Clause 4.2.6, which sets out the power system security principles, which primarily relate to the operation of the power system

<sup>4</sup> Schedule 5.1, in particular, recognises that the function of negotiating access seekers' performance standards is an integral element of TNSPs' power system security role, due to the inter-relationship between technical

As such, and because of the implications for transmission system capability, TNSPs have a legitimate, material and necessary role in the setting of performance standards by access seekers.

Clearly, it follows that TNSPs have a similar role and complementary obligations to that of NEMMCO, which are demonstrably and substantially different to those of access seekers.

However, the AEMC's recommendations 2, 4 and 5 contemplate that TNSPs, like access seekers, would be required to submit performance standards to NEMMCO for approval and compliance programmes to both NEMMCO and the AER, both of whom would have the power to reject that programme if it contained insufficient information or failed to comply with the Rules, or guidelines to be issued by NEMMCO.

Conferring on NEMMCO the function of reviewing and approving TNSPs' network performance standards, and programmes for compliance with these standards, is inconsistent with the existing allocation of power system security responsibilities between NEMMCO and TNSPs. Furthermore, ETNOF maintains that it is not appropriate to subject TNSPs to the same, or even a substantively similar, regime for the determination, compliance and enforcement of performance requirements as is applicable to access seekers, as contemplated by these recommendations.

As discussed above, TNSPs have a fundamental role in the Rules of planning, developing, operating and maintaining networks to ensure a reliable and secure system. Transmission providers, and indeed NEMMCO, have broad system security obligations that are central to their role in the NEM. For access seekers however, system security obligations are usually a secondary consideration to competitive energy provision or purchase.

Also, the mandatory nature of the performance obligations for TNSPs, set out in schedule 5.1, that relate to achievement of adequate levels of network power transfer capability, and quality of supply, for the common good of all registered participants, and their network-wide application, render the application of the approval process that is proposed for the technical performance of access seekers superfluous<sup>5</sup>. There is no scope for TNSPs to negotiate reduced standards of network performance in respect of these requirements<sup>6</sup>, that is, there is no analogy in the network performance standards to 'negotiated access standards'. Thus, there is no benefit to approval of these network performance standards, and associated compliance programmes.

The motivation or drivers on TNSPs are different. For example, TNSPs are driven to meet regulatory obligations first and foremost and the regulatory framework provides them with a reasonable opportunity to recover the efficient costs of meeting those obligations (refer

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performance at a specific connection point and network-wide performance. The introduction to Schedule 5.1 (in S5.1.1) makes this particularly clear.

<sup>5</sup> Schedule 5.1 'describes the planning, design and operating criteria that must be applied by *Network Service Providers* to the *transmission networks* and *distribution networks* which they own, operate or control' (S5.1.1). As outlined in the introduction to S5.1.1, these criteria in schedule 5.1 fall into two categories:

“(a) those required to achieve adequate levels of *network power transfer capability* or quality of *supply* for the common good of all, or a significant number of, *Registered Participants*; and  
(b) those required to achieve a specific level of *network service* at an individual *connection point*.”

Those network performance criteria in the former category are expressed in mandatory and unambiguous terms (see, for example, the first paragraphs of S5.1.3 (frequency variations), S5.1.4 (magnitude of power frequency voltage), S5.1.5 (voltage fluctuations), S5.1.6 (voltage harmonic or voltage notching distortion); S5.1.7(a) (voltage unbalance); S5.1.8 (stability) etc.).

<sup>6</sup> A network user may negotiate a different level of network performance in respect of an individual connection point to that otherwise required by schedule 5.1, under clause 6.5.8(f) and in accordance with clause 6.5.9. That is, the network performance criteria that fall in category (b) described in the introduction to S5.1.1 (set out in the preceding footnote) are potentially subject to negotiation. However, the network performance criteria 'for the common good' (i.e. those criteria in category (a)) are not negotiable.

Section 16 of the National Electricity Law). Revenue cap decisions provide a return on capital expenditure associated with meeting these obligations, as well as including incentive payments linked to reliability performance. This compares with access seekers that are subject to market pressures, which often encourage different priorities, such as keeping costs down to ensure profitable outcomes in a competitive context.

Critically, the scope of the compliance task is far greater for TNSPs than for individual access seekers in that the number of individual elements involved in meeting standards is far greater. Most TNSPs have their network facilities distributed across dozens of sites. For instance ETNOF members have over 300 substation sites. These sites are often developed over a number of years and incorporate equipment and control and protection systems of varying vintages and technologies. This means that a single suite of compliance tests cannot be simply rolled out across all sites. In contrast, access seekers' facilities are normally a small number of discrete units on a single site, and typically of the same or similar technology and design.

From a practical perspective the technical obligations imposed on TNSPs, given the large scale and interconnected nature of the network, are often not amenable to performance testing of discrete components.

All of these elements discussed above necessitate that the compliance regimes instituted by TNSPs are inherently different from those of access seekers, and by definition will not comprise the same sort of objectively observable tests that access seekers are able to conduct. The Rules currently and properly recognise this through clause 5.7.4.

## **2.4 The Role of Penalties in the Proposed Regime**

Recommendation 12 proposes a further AEMC review into the appropriate penalties for breaches of technical standards to be completed before June 2007. In general terms, such review would appear to be appropriate.

ETNOF agrees with the AEMC view that it is inappropriate to review current levels of penalties until performance standards are settled and a detailed assessment of their enforceability has been conducted. In particular, the proposal to introduce a higher level of penalty, similar to the rebidding penalty, would pre-empt the findings of the review.

ETNOF suggests that good governance principles would dictate that the penalties regime should be designed so as to be mindful of the drivers and wilfulness of any breach, as well as the outcome that is being sought by the party breaching the rules. For example, pecuniary fines on commercial organisations that have the potential to be motivated to deliberately breach the Rules to reap windfall profits by manipulating market outcomes are justifiable. However, non-market participants, such as regulated TNSPs, do not have any incentive to deliberately breach the Rules to manipulate the market to make windfall gains.

In addition, adopting a penalty similar to rebidding is just one option, which, of itself, appears to be of questionable merit. Imposition of personal fines of \$1 million appears to be disproportionate and impractical. Fines of this level go beyond deterrent value into the realm of excessively punitive.

Furthermore, the recommendation should include a requirement that the review consider tailoring the penalty regime to the form and role of the participant concerned, and any other non-Rules based sanctions that may already exist. Transmission network owners, for example, are already subjected to strong incentives to meet mandatory obligations, including potentially significant liabilities to affected third parties. Further, as already noted, they are not entities, which stand to make significant windfall gains through deliberate (or inadvertent)

breach of the Rules, as arguably is the case in relation to other market participants. In the absence of such potential incentives to breach, an equal and opposite level of penalty for deterrence is not necessary.

## **2.5 Summary of Substantive Position**

The AEMC's recommendations need to be revised in relation to TNSP and NEMMCO technical performance compliance and enforcement. Specifically, revision is required to address the following considerations:

1. NEM governance arrangements, established by the Council of Australian Governments, and the Ministerial Council on Energy, as reflected in the Australian Energy Market Agreement (as amended in 2006) and the National Electricity Law, do not support the proposed expansion of NEMMCO's compliance and enforcement role.
2. There are no apparent shortcomings with the current processes for ensuring NEMMCO and TNSPs meet their system security related Rules obligations, nor has the AEMC made a case that its proposed changes in this regard enhance the achievement of the NEM Objective. The TNSPs are already required to have compliance programs in place and these must be provided to the AER as required by the AER. The extent of AER Rules compliance oversight can already be adjusted, as proposed in the AEMC's paper, to reflect the level of concern the AER may have with TNSP, or NEMMCO, commitment to any aspect of Rules compliance.
3. A number of the AEMC's recommendations propose the introduction of arrangements for access providers (e.g. TNSPs) that 'mirror' the requirements for access seekers despite fundamental differences in the requirements for each class of participant. ETNOF has shown in this submission that this is both inappropriate, and implies far more fundamental, and far reaching, changes to the Rules than appears to have been recognised by the AEMC.
4. Proposals for the imposition of very high levels of fines need to more fully recognise the different drivers on the bodies involved. TNSPs are encouraged by their current regulatory arrangements to deliver a secure and reliable system, whereas access seekers are subject to market pressures that often encourage different priorities. High levels of individual fines can also create dysfunctional behaviour, such as discouraging timely disclosure and rectification of problems.

## **3. ETNOF Position on AEMC Draft Recommendations**

1. ***That NEMMCO and/or the electricity supply industry request a Rule change that proposes to:***
  - ***put in place a process to settle the content of deemed performance standards for existing generator plant and specifically documents the performance standards for each generator;***
  - ***impose a 30 June 2007 deadline for completion of that process;***
  - ***require that generators provide NEMMCO with a confidential copy of the relevant connection agreement;***
  - ***provide for binding and enforceable arbitration to resolve particular issues where the parties disagree and gives the arbitrator the powers to perform this role including the power to compel the production of relevant documents; and***
  - ***the development of which has specifically involved consultation with the AER.***

ETNOF supports the intent of this recommendation and agrees that clarification of the performance standards of existing generators should be undertaken urgently, in that it provides a tangible benefit to the operation and security of the electricity network. ETNOF is aware of the ongoing work to prepare this Rule change proposal and has been consulted during this process.

It should also be recognised that the resulting performance standards have implications for transmission service performance. That is, current transmission system capability, as reflected in constraint equations, may change as a result of changes to some performance standards. This can have transmission planning and investment implications. Accordingly, TNSPs need to be kept informed of the outcomes of this process.

Furthermore, ETNOF strongly objects to the recommendation that complete connection agreements be provided to NEMMCO. In addition to the negotiated performance standards that are established through tripartite discussion and agreement, the connection agreement documents contain confidential commercial arrangements negotiated bilaterally between the TNSP and generator. There is no operational or commercial need for NEMMCO to receive a copy of the connection agreement, and thus, the generator should only be compelled to provide NEMMCO with the relevant performance standards contained in the connection agreement.

**2. That the AEMC will undertake a review of the following matters by 30 June 2008:**

- ***the process for revising the technical standards;***
- ***whether and how performance standards should be reviewed following changes to those standards;***
- ***whether NSPs should be required to submit to NEMMCO, and conform with, performance standards and what the content of those performance standards should be; and***
- ***whether there are any changes that should be made to the technical and performance standards regime to improve its effectiveness with respect to market customers and MNSPs.***

ETNOF supports the proposal for the AEMC to undertake a review of the process for revising technical standards and consequent changes to performance standards. In particular, ETNOF would welcome the specific consideration of the practical considerations associated with testing to verify stated technical performance.

However, the proposal that a TNSP submit separate performance standards to NEMMCO is a significant shift that ETNOF does not consider necessary or appropriate. Existing performance standards applying to TNSPs under the Rules are sufficient and were developed with the input of NEMMCO.

This proposal also fails to recognise the distinctive roles of TNSPs and NEMMCO. TNSPs are responsible for the delivery of a reliable system capable of operating in a secure state. NEMMCO is responsible for the operation of that system in a secure state. Consequently, ETNOF sees no compelling reason to consider changing the process and incurring additional compliance costs without an identified commensurate benefit.

ETNOF notes that the AEMC's draft report also refers to the TNSP's role in setting performance standards for access seekers. As quoted by the AEMC in their draft report, the NGF stated that:

*“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.”*

TNSPs have mandatory performance standards under schedule 5.1 of the Rules which must be met. The scope to shift the cost of compliance with these requirements to access seekers is limited. In particular, TNSPs are required to negotiate and agree performance standards only where the connection applicant has proposed an arrangement that does not meet the automatic access standard for any or all technical requirements. This is not a quasi-regulatory role, but a role inextricably linked with the planning of the transmission network and compliance with quality of supply standards.

Clause 5.3.3(b1)(4) of the Rules requires the TNSP to declare to the applicant, at the commencement of the application query, those technical requirements for which NEMMCO is responsible, i.e. those requirements that relate directly to operating the system in secure state and which are specifically identified in Schedule 5.2. Furthermore, clause 5.3.4A(b) requires a TNSP to:

*“consult NEMMCO on all matters allocated to NEMMCO under clause 5.3.3(b1)(4) and **must** [emphasis added] accept NEMMCO’s advice in respect of those matters”.*

This effectively means that the TNSP is a “post box” for the key performance standards that relate to operating the system in a secure state.

Therefore, a TNSP is free to negotiate with the applicant, within the bounds of the requirements of the Rules, only those technical requirements that relate directly to quality of supply or the capability of the system being ‘delivered’ by the TNSP. Further, when negotiating the access standard, and in addition to being required to negotiate in good faith, a TNSP must have regard to clause 5.3.4A(a)(3) which requires that the standard must:

*“be set at a level that will not adversely affect the quality of supply for other Network Users.”*

This is consistent with the key underlying concept of this part of the Rules. That is new connections to the network should not impact upon the level of service or quality of supply of existing connected parties. This is illustrated by clause 5.3.5(d) of the Rules:

*“**So as to maintain levels of service and quality of supply to existing Registered Participants in accordance with the Rules** [emphasis added], the Network Service Provider in preparing the offer to connect must consult with NEMMCO and other Registered Participants with whom it has connection agreements, if the Network Service Provider believes, in its reasonable opinion, that compliance with the terms and conditions of those connection agreements will be affected, in order to assess the application to connect and determine:*

- (1) the performance requirements for the equipment to be connected;*
- (2) the extent and cost of augmentations and changes to all affected networks;*
- (3) any consequent change in network service charges; and*
- (4) any possible material effect of this new connection on the network power transfer capability including that of other networks.”*

While the introduction to Schedule 5.1 (S5.1.1) similarly refers:

*“Where it is intended to apply a negotiated access standard in accordance with clause 5.3.4A of the Rules, the Network Service Provider must first be satisfied that the application of the negotiated access standard will not adversely affect other Registered Participants.”*

Because of the implications for transmission system capability, TNSPs have a legitimate and material interest in the setting of performance standards for access seekers.

- 3. *That, in parallel with the AEMC’s own review, the AEMC will direct the AEMC Reliability Panel to undertake a review of technical standards (which is consistent with the Reliability Panel’s forward work program).***

While ETNOF supports this approach in principle, there could be sequencing issues with the Reliability Panel undertaking a review of technical standards at the same time the AEMC is deciding the future basis of such reviews. As noted in 2 above, ETNOF would welcome the Reliability Panel review, should it proceed, to give specific consideration to the practical issues associated with testing to verify stated technical performance.

- 4. *That the MCE request a Rule change that proposes to establish a requirement that NEMMCO issue guidelines setting out specific requirements for generator and NSP compliance programs. These guidelines should be subject to the Rules consultation procedures.***

ETNOF does not support this recommendation on three grounds.

Firstly, it is not appropriate for NEMMCO to be issuing guidelines relating to compliance programmes for the technical performance of the transmission system. This is a role that should be performed by the AER as the body charged with monitoring and enforcing compliance with the Rules.

Secondly, performance standards applying to TNSPs are expressed in non-negotiable terms in the Rules. These standards have been substantially complied with by TNSPs. It is therefore not apparent that additional TNSP compliance processes are required.

Thirdly, such additional compliance processes are likely to result in increased cost to TNSPs that will, ultimately, be borne by consumers. In the absence of any TNSP compliance 'problem' we consider that any such requirements would be unlikely to meet the NEM objective. Under current arrangements the AER already has the power to 'ramp up' compliance monitoring should the AER conclude that TNSPs, or NEMMCO, are not committed to meeting the requirements of the Rules. This enables the costs of compliance oversight to reflect needs, and is consistent with the flexible enforcement principles set out in the AEMC’s draft report. This approach also contributes more effectively to the NEM Objective by only increasing compliance costs where necessary.

- 5. *That the MCE request a Rule change that proposes to replace the current framework for determining generator and NSP compliance programs with the following:***
- *requiring generators, market customers, MNSPs and NSPs to submit a compliance program to NEMMCO and the AER that is consistent with the compliance program principles in the Rules and NEMMCO compliance program guidelines;*
  - *giving the AER and NEMMCO specific powers to reject a compliance program if it either contains inadequate information or does not comply with the requirements of the Rules and NEMMCO guidelines; and*
  - *requiring the AER and NEMMCO to each notify the generator, market customers, MNSPs or NSP of their decision in writing and give reasons.*

To the extent that any such requirement for TNSP compliance programmes is found to be desirable, this role should be performed by the AER. The AER would remain able to consult with NEMMCO as it sees fit in this process. This is consistent with NEM governance arrangements and avoids possible confusion of roles between the AER and NEMMCO.

In the event that the AER is required to ‘approve’ compliance programmes this should be a formal and transparent requirement on the AER to ensure that accountability for the approved programme is clear.

- 6. *That the MCE request a Rule change that proposes to add a clause that states that the timely notification to NEMMCO of a breach of a performance standard under clause 4.15(f) must be taken into consideration in any proceeding against a Registered Participant for a breach of clause 4.14(a).***

ETNOF supports this recommendation.

- 7. *That the MCE request a Rule change that amends Clause 4.15(j) to ensure that that NEMMCO is required to take the cost to the market of a continued breach into consideration in determining an appropriate rectification timeframe.***

ETNOF supports an arrangement where NEMMCO advises the AEMC on the system and market implications of a breach. However, rectification of a breach is an enforcement option (or breach remedy) in the same way that imposing a fine is. As such, it is a matter for the AER to decide how long the participant should be given to rectify a problem.

Furthermore, NEMMCO would not have all of the required information or technical competency to assess the cost of a continued breach, i.e. knowledge or understanding of resolution options open to generators and/or TNSPs or the relative costs and risks associated with many of these options for managing a breach. However, NEMMCO is in a position to provide the AER with guidance on the implications for system performance and the AER can have regard for such advice in deciding an appropriate remedy for a breach by a market participant.

- 8. *That the MCE request a Rule change that proposes to allow the AER to determine a timeframe for rectification if a Registered Participant disagrees with NEMMCO’s determination of a rectification timeframe under clause 4.15(i).***

ETNOF believes that the AER should determine the timeframe for rectification in the same way that the AER decides when to impose a fine for a breach. This does not prevent the AER from seeking advice from NEMMCO on matters of secure operation of the system to assist in its decision making where appropriate.

- 9. *That the MCE request a Rule change that proposes to clarify the wording in clause 4.15(i) to make clear that the Registered Participant has an obligation to rectify a performance standard breach within the time specified by NEMMCO so that a failure to rectify will be considered a breach of the Rules by the Registered Participant.***

ETNOF would support this recommendation if the AER were substituted for NEMMCO in this recommendation. This does not prevent the AER from seeking advice from NEMMCO on matters of secure operation of the system to assist in its decision making where appropriate.

- 10. *That the MCE consider prescribing clause 4.15(i) as a civil penalty provision in Schedule 1 to the National Electricity (South Australia) Regulations.***

ETNOF supports this recommendation, subject to the quantum being reasonable.

**11. That the MCE request a Rule change that proposes to require NEMMCO to provide all relevant information on performance standard non-compliances or potential non-compliances to the AER.**

ETNOF supports this recommendation.

**12. That the MCE directs the AEMC to conduct a further review into the appropriate penalties for breaches of technical standards to be completed before June 2007, once the process of determining deemed performance standards for existing plant is completed. The further review should consider and further develop the Commission's preliminary views that:**

- **breaches of technical standards should move from strict liability to fault-based liability;**
- **any benefits accruing to the Participant that breached technical standards be considered in determining an appropriate penalty;**
- **if recommendations for fault-based liability and removal of benefits resulting from technical breaches are adopted, a higher level of penalty, similar to the rebidding penalty is likely to be appropriate; and**
- **the Rules should include additional factors that should be considered in determining a penalty for a breach of a performance standard.**

ETNOF supports this recommendation but notes that high penalties (similar to the rebidding penalty) are only necessary where a market participant has a commercial incentive not to comply, or the cost of breach may be exceeded by the windfall gains of the breach.

Further ETNOF considers that any increased penalties should be coupled with guaranteed relief from penalty for timely notification to NEMMCO and the regulator (AER) of a breach.

ETNOF does not consider personal fines to be appropriate. Industry sectors where such personal penalties are applied are in areas where businesses, and individuals within those businesses, have the ability to 'game' a process and generate significant personal as well as business returns. TNSPs are heavily regulated businesses and they, and individuals within these businesses, do not have such ability or motivation to generate such 'illegal' returns and therefore personal penalties are not necessary or appropriate.

**13. That the MCE notes:**

- **the comprehensive approach to managing the identified issues in the technical and performance standards, and their compliance and enforcement;**
- **the existing AEMC workstream relating to technical standards for wind generation;**
- **the intention to establish the AEMC-AER working group to oversee the ongoing program of work relating to technical standards, which will report regularly to the MCE on progress; and**
- **that the specific Rule drafting of recommendations 4 – 10 could be undertaken by the AEMC as part of its final report.**

ETNOF does not support the wider issues proposed in NEMMCO's proposed Rule change and urges the AEMC to address such issues through wider review prior to implementing a specific Rule change.

Furthermore, ETNOF believes that recommendations 4-10 would benefit from wider industry review prior to formal Rule change proposals being consulted upon. For instance, the requirement for TNSPs to submit a compliance programme to NEMMCO for approval is a substantial shift from the current arrangements and could result in additional costs due to the increased compliance burden with no material benefits as explained above.