

Submission to Australian Energy Markets Commission

Re: Enforcement and Compliance with Technical Standards Under the National Electricity Rules



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TABLE OF CONTENTS

1	INTRODUCTION.....	2
2	ALINTA'S KEY SUBMISSION POINTS	2
3	ALINTA'S RESPONSES TO THE COMMISSION'S QUESTIONS	3

Enforcement and compliance with technical standards

1 Introduction

The Ministerial Council on Energy (MCE) has directed the Australian Energy Market Commission (the Commission) to conduct a review of the enforcement of, and compliance with, technical standards under the National Electricity Rules (Rules). The review follows a number of incidents in the National Electricity Market (NEM) in which plant has failed to meet expected standards of performance, resulting in large amounts of load shedding.

The terms of reference for the review noted (in paragraph 1.5) that the recent examples of plant failure highlighted inadequacies in the NEM arrangements, particularly with regard to:

- enforcement of and compliance with the technical standards under the Rules;
- the ability of those compliance arrangements to deal with any potential breach expeditiously;
- the potential for perverse incentives on market participants; and
- the level of penalties under National Electricity Law.

Against this background, the MCE has asked the Commission to review the investigative, rectification and penalty provisions under the Rules to ensure an effective compliance and enforcement regime.

Alinta welcomes the opportunity to make this submission to the Commission's Issues Paper, which has been released in accordance with the terms of reference set by the MCE.

The remainder of this submission first provides an overview of Alinta's key points before addressing the 22 questions posed by the Commission.

2 Alinta's key submission points

Notwithstanding the events that have triggered the Commission's consultation on enforcement and compliance with technical standards under the Rules, Alinta considers that overall, the present arrangements are reasonably effective.

The key points that Alinta wishes to make are as follows:

- The possibility of public disclosure of a company's non-compliance (under the present arrangements) is likely to provide a powerful incentive for compliance. However, breaches that are immaterial in terms of their impact on system security should not be

Enforcement and compliance with technical standards

publicly reported as this will tend to reduce the impact and effectiveness of public disclosure.

- Punitive measures for non-compliance, while an important element of the arrangements, need not be strengthened because such action would not increase the present incentives for compliance. Instead, greater emphasis should be given to proactive measures, such as auditing of compliance programs of key participants.
- Any decisions to unwind existing derogations, or change technical standards should be evaluated by applying a rigorous economic framework that considers the costs and benefits of change proposals.
- The existing provisions are unrealistic in expecting a participant to meet an absolute standard of compliance. As a general principle, the required standard of compliance should appropriately balance costs, benefits and risk.
- National Electricity Market Management Company (NEMMCO) should be afforded a reasonable amount of discretion in determining matters within its remit. The Rules should stipulate matters that NEMMCO must have regard to in exercising its discretion.
- The Australian Energy Regulator (AER) should be responsible for taking enforcement action in the event of a material breach. However, it is appropriate for the AER to rely on NEMMCO's technical expertise especially in relation to monitoring compliance and in determining rectification measures in the event of a breach. To avoid duplication of roles the AER and NEMMCO should establish a memorandum of understanding (MOU). The MOU would describe in reasonable detail the respective roles and responsibilities of the AER and NEMMCO in relation to compliance monitoring and enforcement, thereby ensuring that the framework is effective and robust.

3 Alinta's responses to the Commission's questions

Q1. Are there other technical standards that Commission should consider in this review?

The Issues Paper provides a reasonable summary of the technical standards under the Rules. Depending on the scope of its review, the Commission may also like to consider whether there is a need for a more consistent approach to be adopted in the treatment of fast start and slow start generators in the dispatch process. It may also be beneficial for the review to consider information technology system standards, particularly in relation to the dispatch process.

Q2. Is the process for establishing new performance standards effective in achieving desired outcomes for the power system? Is NEMMCO's role in the process effective or does it need to be more clearly defined?

Enforcement and compliance with technical standards

Alinta notes that the question could be worded more clearly as the Rules referred to in the Issues Paper do not relate to the establishment of new performance standards, but rather relate to performance standards for new connections.

From Alinta's perspective, it appears that the existing provisions are reasonably clear in terms of describing NEMMCO's role and the objectives that must be met in determining a negotiated access standard. In particular, Alinta notes that clause 5.3.4A(a) states that a *negotiated access standard* must:

- (1) be no less onerous than the corresponding *minimum access standard* specified by the *Network Service Provider* in accordance with clause 5.3.3(b1)(2);
- (2) be set at a level that will not adversely affect *power system security*; and
- (3) be set at a level that will not adversely affect the quality of *supply* for other *Network Users*.

Clause 5.3.4A(b) requires a Network Service Provider (NSP) to consult NEMMCO on all matters allocated to NEMMCO under clause 5.3.3(b1)(4) and the Network Service Provider (NSP) must accept NEMMCO's advice in respect of those matters in determining its response to each proposed negotiated access standard. The only area of doubt in the existing Rules relates to determining which items are allocated to NEMMCO under clause 5.3.3(b1)(4).

In this regard, Alinta believes that the commission should take careful account of NEMMCO's views in relation to how these provisions have worked in practice and whether more guidance in the Rules would deliver better outcomes in terms of negotiated access standards.

Q3. Are performance standards for existing plant, which were defined with reference to a derogation, an accurate representation of the capability of the plant? Are there events that should trigger a review?

Alinta recognises that there needs to be a balance struck between:

- honouring existing derogations (and hence, in effect preserving pre-existing property rights) where there has been a genuine rationale for a modified standard of performance;
- recognising the changes, or expected changes, in the power system which may mean that the system-wide costs of allowing the existing derogations to continue are now much greater than at the time the derogations were first granted; and
- ensuring that competition between generation plant is not distorted as a consequence of the existing derogations.

Enforcement and compliance with technical standards

Alinta notes that it is not possible to balance carefully these competing objectives without examining each case on its merits, and by applying an economic framework that considers the costs and benefits of unwinding existing derogations. In considering the costs and benefits it is important to consider both the private costs to the particular generator, and the wider system costs. Where there is a strong case for unwinding an existing derogation, a number of important matters would need to be considered, such as:

- specification of an appropriate transitional period;
- the question of whether any compensation should be paid to the party whose rights are reduced or obligations increased; and
- the funding of any compensation.

It is not clear which body would be responsible for conducting a review of the existing derogations. Alinta believes that NEMMCO should have a role as system operator, but the final decision should probably rest with the AER. It is a matter for the Commission to consider whether it is practical to define some principles in the Rules to guide the AER's approach and NEMMCO's involvement.

Alinta is not in a position to express an informed view as to whether performance standards for existing plant, which were defined with reference to a derogation, provide an accurate representation of the capability of the plant. We would expect other participants and NEMMCO to be in a position to express informed views on this matter.

It may be appropriate to review derogated standards periodically, or in the event there is a system incident in which derogated standards may have been a contributory factor. Other than this, it would seem both difficult and unnecessary to attempt to define specific triggers for a review of derogated standards.

Q4. Should there be a mechanism to modify a performance standard, either at the request of the participant or to take account of changes in the requirements on the power system?

It is appropriate for the Reliability Panel to set minimum standards. Where a participant does not presently comply with the revised minimum standards, issues similar to those identified in response to question 3 (above) arise. Alinta therefore believes that a similar economic evaluation framework could apply to a consideration of changes to minimum standards as could apply to a review of the appropriateness of existing derogations.

Q5. Are there any aspects of the content of the various technical standards specified in the Rules that require clarification?

See comments in relation to question 1.

Enforcement and compliance with technical standards

Q6 Is the current framework for compliance programs effective in establishing and maintaining compliance with performance standards?

Alinta does not have any strong views on whether the current framework for compliance is appropriate and effective. NEMMCO is probably best able to judge the overall level of compliance across the system, and how possible changes to the compliance framework may assist in improving the level of compliance.

Q7 Is it reasonable to expect a participant to meet an absolute standard of compliance when this cannot be guaranteed through a compliance program?

The existing Rules provisions are unrealistic in expecting a participant to meet an absolute standard of compliance. However, a participant must demonstrate that they have effective compliance programs to the satisfaction of NEMMCO. NEMMCO should be afforded a reasonable amount of discretion in determining whether a compliance program is appropriate. However, the Rules should stipulate that NEMMCO must have regard to the size of the plant and its potential impact on system security in determining whether a compliance program is satisfactory.

Q8. Are there sufficient incentives to ensure that all breaches of performance standards are reported to NEMMCO by participants?

Punitive measures for non-compliance would not provide the incentive to ensure all breaches of performance standards are reported to NEMMCO. However, there should be incentives for a participant to take immediate action to rectify a known breach.

Q9 Is the AER the appropriate body to monitor compliance and is its current approach to its monitoring role appropriate? To what extent should it monitor reactively or proactively? What other approaches to the monitoring role may be cost effective?

NEMMCO is the appropriate body to monitor compliance as the responsibility for maintenance of power system security rests with NEMMCO. Reactive monitoring should be limited to instances where a participant has breached standards and has or is likely to endanger the security of the power system.

Greater emphasis should be given to proactive monitoring, by requiring participants to commission audits by external experts. These audits would assess the effectiveness of compliance management and internal governance systems, with reference to the relevant standards set out in the Rules. NEMMCO should set the scope of the audit and approve the auditor. Audits should focus on the participant's performance against its own compliance program – a program agreed to as part of the access agreement.

Enforcement and compliance with technical standards

These proactive audits should be focused on plant and participants whose performance – including any breach of standards - may have an adverse impact on system security. The application and scope of proactive auditing should be subject to a risk-based approach, to ensure that the costs associated with conducting the audits do not exceed the benefits. Proactive monitoring over a period of time would provide information on the effectiveness of compliance programs. The design and implementation of compliance programs can be refined and improved according to the results of the audits.

The AER should be responsible for taking enforcement action in the event of a material breach. However, it is appropriate for the AER to rely on NEMMCO's technical expertise especially in relation to monitoring compliance and in determining rectification measures in the event of a breach. To avoid duplication of roles it is important that the AER and NEMMCO establish a memorandum of understanding (MOU). The MOU would describe in reasonable detail the respective roles and responsibilities of the AER and NEMMCO in relation to compliance monitoring and enforcement, thereby ensuring that the framework is effective and robust.

Q10. Should there be some form of public reporting on the outcome of the AER's monitoring role, including identifying non-compliance instances and what action has been taken to correct those non-compliances?

There is currently public reporting of non-compliance. Alinta notes that the possibility of public disclosure of a company's non-compliance is likely to provide a powerful incentive for compliance. It is important, however, that breaches are not reported if the breach is immaterial in terms of its impact on system security. It is noted, in particular, that public reporting of immaterial breaches will tend to reduce the impact and effectiveness of public disclosure.

Q11. Is NEMMCO's role in determining the timeframe to rectify the breach appropriate and does NEMMCO have sufficient guidance in making that determination?

NEMMCO is best placed to make an assessment and determination on timeframes to rectify a breach, in consultation with affected participants. Alinta's view is that NEMMCO should consider costs, benefits and risk in making that determination.

Q12. Is the enforcement regime, including the powers of the AER adequate for the effective enforcement of breaches of performance standards?

Alinta supports a regime where the AER has the sole responsibility for issuing an enforcement order. The company has no basis for considering that the AER's powers are less than adequate.

NEMMCO's role in the enforcement regime should be to assist the AER in relation to:

Enforcement and compliance with technical standards

- compliance monitoring;
- assessing whether a breach is material; and
- establishing appropriate steps to rectify a breach.

As noted earlier, the respective roles of NEMMCO and the AER should be governed by a MOU.

Alinta believes that the enforcement regime is effective, but notes that the AER and NEMMCO are likely to be best placed to express an informed view on this matter.

Q13. Should NEMMCO be required to inform the AER of potential non-compliance earlier than at the end of the rectification period? Should NEMMCO always refer the issue to the AER or should NEMMCO have some discretion to extend the period for compliance?

NEMMCO should be given discretion to notify the AER of potential material breaches, and should itself determine whether a breach is material. NEMMCO is also best placed to establish a timeframe for rectifying a breach in consultation with the effected participant. If NEMMCO concludes that a participant is highly unlikely to rectify a breach within the agreed timeframe, then it seems reasonable that enforcement action should result. As noted earlier, initiation of enforcement action should, however, be a matter for the AER.

As noted earlier, the details of these arrangements should be set out in an MOU between NEMMCO and the AER.

Q14. Are there other matters that the Rules should require to be taken into account in proceedings?

It should be noted that literal compliance may in some instances prove to be impractical or prohibitively expensive. It is important that the costs and benefits of operating to literal compliance are recognised and balanced, especially where breaches are considered immaterial from a system performance perspective.

Q15. Are there good reasons for having two investigations into power system incidents? Does this dual process assist in resolving issues by separating operational matters from enforcement matters, or does it place an inappropriate burden on participants? Do the AER and NEMMCO have appropriate power to conduct their investigations?

As noted in the Commission's Issues Paper, the aim of each investigation is different. The aim of NEMMCO's investigation is the maintenance of system security by speedy determination and subsequent rectification of all contributing factors, while the aim of the

Enforcement and compliance with technical standards

investigation by the AER is to ensure that breaches of the Rules and the NEL are enforced appropriately.

Both NEMMCO and AER appear to have appropriate powers to conduct their respective investigations. Notwithstanding their different roles, NEMMCO's review would provide factual information to assist the AER in making a decision to undertake its own investigation should NEMMCO report systemic non-compliance or a potentially adverse impact on system security.

The two investigative roles should be co-ordinated to minimise double-handling of information, and the costs and administrative burden imposed on participants.

Q16. Does the threat of enforcement action by the AER act as a disincentive to provide information to NEMMCO on a co-operative basis, if it is to be shared between the two organisations?

It is likely that the threat of enforcement and public disclosure of a breach are the most powerful tools for ensuring compliance. Whilst NEMMCO's role would include public disclosure of breaches, it is possible that information provided to NEMMCO may ultimately lead to the AER taking enforcement action. Naturally, companies will be reluctant to provide information that could lead to such action. By the same token, however, the possibility of enforcement action will encourage participants to comply in the first instance.

Alinta's view is that whilst a co-operative approach should be encouraged, it would be impractical to devise a regime whereby NEMMCO's identification of a breach could not ultimately lead to enforcement action. Alinta believes that the MOU should assist in ensuring that NEMMCO only discloses material breaches to the AER, thereby encouraging as far as practicable a co-operative approach to achieving compliance. The MOU should also seek to encourage early reporting of a breach and negotiation with NEMMCO for the rectification of the breach in order to minimise any on-going risk to system security.

Q17. Are the penalties for breaches of performance standards adequate?

Yes. Current civil penalties are considered adequate.

Q18. Is there a case for determining a technical standards penalty provision which better reflects the potential costs for end users of non-compliance? If so, what should the level of that penalty be?

As noted above, Alinta believes that the current level of penalties is appropriate. Increasing the penalty rate would tend to impose additional costs on participants without any commensurate gain in terms of improved system performance. More importantly, it may be more effective to strengthen compliance monitoring arrangements – to decrease the

Enforcement and compliance with technical standards

likelihood of a breach in the first place - rather than seeking to increase the financial consequences of non-compliance.

Q19. How might an infringement notice approach be applied in ensuring compliance with technical standards? Are there other orders which may assist in ensuring compliance with technical standards?

NEMMCO should have the responsibility to issue an infringement notice with timelines to rectify a breach in consultation with the effected participant. If the breach is not rectified in the required timeframes, then the AER may consider enforcement action.

NEMMCO will need to exercise its own judgement in relation to an appropriate timeframe for rectifying a breach. It will be important for NEMMCO to consult with the relevant participant to ensure that the timeframes are reasonable, having regard to the nature of the breach and the possible consequence of continuing non-compliance. It may be appropriate to set out provisions in the Rules regarding the matters that NEMMCO should consider in exercising its discretion.

Q20. Should NEMMCO be required to consider the commercial incentives or opportunities provided by its actions in managing the impact on power system security of a breach of performance standards?

NEMMCO should not focus on commercial incentives per se in making system operational decisions. It will be relevant to consider whether the breach is wilful, in which case there may be grounds for NEMMCO to advise the AER of the breach, so that appropriate enforcement action can be initiated by the AER. However, it is important for NEMMCO to maintain its focus on system operation and system performance rather than straying into areas of market regulation.

Q21. Is clause 5.7.3(e) sufficiently clear to allow NEMMCO to use this clause to manage a power system incident?

This is a matter for NEMMCO.

Q22. What other alternatives could be considered to address the issue of a participant gaining financially from a breach of its performance standards?

As noted earlier, Alinta does not believe that financial gains are relevant in terms of ensuring that there is an effective compliance and enforcement regime. The primary concern should be to ensure that there is a level of compliance commensurate with the maintenance of appropriate system performance. The question of whether there are financial gains from non-compliance is not a particularly relevant consideration.