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25 July 2006

Dr John Tamblyn
Chair
Australian Energy Market Commission
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Dear Dr Tamblyn

Review of enforcement and compliance with technical standards

We refer to the AEMC's review of enforcement and compliance with technical standards and submit our response as follows. For consistency we have responded directly to the recommendations that have been put forward by the Commission in this draft report.

1. NRG agrees with the recommendation that a Rule change be proposed which establishes a process to deliver appropriate grandfathering of technical performance standards for existing generators via a deeming mechanism, recognising the flaws in the current regime. The NGF along with NEMMCO and the AER are working together to achieve this outcome.

   The requirement to provide NEMMCO with a copy of the connection agreement is accepted but is certainly not a new requirement. Clause 5.2.3 (c) of the Rules already requires the NSP to provide information to NEMMCO where there are variations between the connection agreement and the requirements of Chapter 5 of the Rules. The connection agreement is however a confidential document between two parties (sometimes more) and does address other commercial terms and conditions than just the technical standards. It is therefore our position that only those terms and conditions particular to the technical performance standards are made available to NEMMCO.

   Arbitration in circumstances where the parties are unable to come to a resolution is accepted. This should have been part of the original technical standards regime due to the nature of what was being negotiated, and limited onus on some parties to negotiate. NRG is of the view that this approach will certainly strengthen the good faith negotiation process between generators and NSP's/NEMMCO.

NRG accepts the recommendation that the AER should be part of the process and we believe that this has occurred through the Rule change proposal process to date.

2. It is our view that the Commission should undertake a further review to comprehensively investigate the aspects as detailed in the Draft Report recommendations under item 2.

The question of whether NSP's should submit and adhere to technical performance standards is also appropriate in light of this type of review. NRG's position is that even though NSP's do have some level of service standards prescribed within the Rules, it is certainly not as comprehensive as that outlined for generators nor does it attract the level of enforcement rigour that is faced by generation participants.

Currently there appears to be little enforcement ramifications to NSP's for network failures that impact on the market.

NRG's position is that it is not only the responsibility of generators to ensure that the NEM operates in a reliable and secure state, rather it is a shared responsibility with the NSP's and NEMMCO, given the complex interactions within the interconnected power system. In line with this logic, all three need to have reflective and appropriate technical performance standards in place.

It is also agreed that a broad review of the process for technical standards revision and plant upgrade should be undertaken by the Commission, recognising that it is uneconomic to mandatorily require existing plant to be upgraded to meet higher technical standards. A plant can only be held to account for the technical capabilities it was originally designed to achieve. However, greater certainty and clarity in the process for revising technical standards would be welcomed.

3. NRG supports this recommendation. It is vital that a comprehensive review of the content of the technical standards is undertaken, including the appropriateness of individual standards and the interaction between the standards.

4&5. The Rules currently allow for a negotiation process between generators, NSP's and NEMMCO to agree on a compliance monitoring program. It is also noted that the Rules only put the responsibility of "good faith" negotiations on generators which seems to put an unequal onus on the parties, particularly when generators are dealing with a natural monopoly and NEMMCO who also have a role in ensuring that the network capability is maximised.

A collaborative approach to formulating compliance monitoring programs that are specific to each generation company is reasonably appealing and as such NRG would favour a

process whereby NEMMCO was not entrusted solely with the responsibility of setting and issuing additional guidelines. A more collaborative approach should be adopted that would include NEMMCO and the AER (if they wished to be involved at this level) as the decision makers, working with the relevant generators and NSP's, as required.

The process of submitting an adequate or suitable compliance program to NEMMCO and the AER must be based on a consistent set of guidelines. It is noted that NEMMCO has been working on a pro forma style compliance program for participants to use. This pro forma must be designed and agreed by generation and NSP participants prior to it being adopted by the AER and NEMMCO as the preferred mechanism for assessing compliance program submissions. This guideline should also be outcome focused and technology neutral, and sufficiently flexible to enable technical conformance to be demonstrated in an efficient and appropriate manner for the particular plant concerned. Such principles could be usefully included in the Rules.

If both NEMMCO and the AER have the ability to reject a compliance program it needs to be made clear what the process is going forward, with the following issues needed to be addressed:

- It is unclear what rights of appeal a participant has in relation to their compliance program being rejected. Perhaps the arbitrator could be used in instances where the participant was of the view that the rejection of their compliance program was not warranted.

- It is presumed that the AER and NEMMCO would caucus prior to rejecting or accepting a plan and that a situation would not arise where one party accepts a program and the other rejects it.

- After rejecting a compliance program the participant would generally need adequate time to resolve the issue and resubmit.

- The rejection of compliance programs should not only give reasons for rejection but may want to provide suggestions of what would be acceptable to ensure that participants resolve outstanding issues in a timely manner.

6. The AEMC has proposed that the MCE request a Rule change that effectively takes into consideration any timely notification to NEMMCO of a breach or potential breach of a technical standard. On the surface this appears to be a reasonable approach in that any early action seems to be rewarded as mitigating or intending to mitigate any proceedings that the AER is likely to take in relation to the breach.

NRG is however concerned with this process in that any notification of a breach or potential breach could attract proceedings against a participant for breach of Clause 4.14(a) of the Rules. This does not appear to be consistent with the concept of moving from a strict liability regime to a fault based regime as discussed in the draft report. It also does not sit well with what most participants in the market would consider a more appropriate mechanism, based on a more light handed approach. The "benign big gun" approach as described within the Draft Report (Ayres and Braithwaite) seems more appropriate in that a penalty is set as the deterrent and ultimate sanction. The approach as described in the Commission's report is that the *"central principle here is that a regulator should have available a range of enforcement mechanisms in order to be responsive to the particular type of non compliance it faces in any individual situation"*. The approach recommended to the MCE is based more on a strict liability approach which does not allow flexibility in the way a breach or potential breach is dealt with. The approach certainly does not create a pyramid style of mechanism whereby participants would be more inclined to openly acknowledge, report and remedy breaches.

The approach to breaches and potential breaches should from NRG's perspective have a reasonable amount of flexibility built into it to allow for NEMMCO and the AER to consider the materiality of the breach, the time to remedy the breach and any mitigating circumstances.

Therefore the approach that NRG would encourage is as follows:

- Participants are to register applicable and agreed technical performance standards with NEMMCO in line with proposed Rule change to incorporate adequate grandfathering of technical standards.

- Participants are to submit applicable and agreed compliance programs which would detail tests, monitoring practices and routine checking of generation plant that would ensure generation plant was operated and maintained to good electricity practice.

- Any penalties associated with technical standards be directly related to adherence to the compliance program and only to the technical standards where a breach has occurred and a timely remedy of that breach has not occurred, ie the relevant test is whether a generator that has instituted a compliance program has ensured that all aspects of that program were adhered to in accordance with good electricity industry practice.

- Any audit or NEMMCO finding indicating a breach of the requirements of the compliance program would be reported to the AER.

- AER would assess the materiality of such a breach and would provide the participant with a notification of the breach and the remedial action required.

- If the breach was material and the participant did not remedy the breach within an agreed timeframe or on remedying the breach was found on a subsequent audit to have another identical material breach, then the AER would have the discretion of instigating proceedings against the participant with the aim of imposing a financial penalty alongside any remedial action.

- Where a participant through a market event or general operation of its plant has been non compliant in meeting a registered technical standard, the AER and NEMMCO need to provide the participant with such evidence and require the participant to review and/or put in place a program to ensure compliance with that standard, as appropriate. This could involve further negotiation or modifications to compliance methods. There needs to be an agreed timeframe to allow for this remedy. If a participant is remedying the breach within the specified timeframe and another breach of that standard takes place, the participant should not be penalised because they are working to an agreed process to remedy that breach.

This process binds a participant to comply with its compliance program as the primary mechanism to technical performance compliance. Therefore as long as a participant adheres to the compliance program and rectifies any breach of its registered technical standards, they will be deemed to have complied with the Rules and as a result cannot have penalty proceedings initiated against them.

This creates a positive and transparent process whereby participants are willing to report and remedy breaches at a compliance program level without fear that such reporting will in the first instance result in a breach and/or proceedings. The Commission would also be aware from previous submissions on technical standards that some breaches of technical standards cannot be prevented from a generation position because it is not possible to fully test plant capability in some areas, fault ride through capability being a classic example.

7. The recommendation to have NEMMCO take into consideration the cost to the market of a continued breach when determining an appropriate timeframe for rectification is not supported. Firstly, NEMMCO should not be determining winners and losers from a technical breach but rather should work with the respective participant to address the issue and set agreed remedial timeframes. In all material instances the participant needs to be set a tight timeframe that is not impossible to meet.

   Secondly, NRG would query the basis on which NEMMCO would make an assessment on costs to the market. Would it only be on what would be material from a customer

perspective, ie a blackout, or are they attempting to make a judgement call on what costs market participants would have incurred. Of course this would be extremely difficult given contract positions, cost of fuel, insurance cover and force majeure clauses in contracts. NEMMCO has itself emphasised the difficulty of making subjective commercial judgements, which would represent a dangerous departure from the established role of the independent market operator. Whilst the previous submission made by NRG Flinders is not acknowledged in the Draft Report, we also refer you to our earlier comments on this issue, noting the difficulty of making subjective judgements over the market impacts of system events and operating restrictions.

We are of the view that some breaches will cause a cost to the market but this should not impact on NEMMCO's assessment of the timeliness of the remedy. Rectification should instead be based on technical considerations and system security impacts alone.

The Draft Report also raises the issue of whether market constraints can operate in a manner as to provide participants in breach of a technical standard with a commercial benefit, potentially creating a perverse incentive to reward a participant for failing to rectify a breach.

Again we point you to our earlier submission but again comment that if a structured mechanism was introduced to ensure agreed remedial actions and timeframes the participant cannot be penalised for any market constraint that may bind due to the initial breach. NEMMCO's role as an independent market operator is not to pick winners or losers in formulating constraints but rather to ensure the market is dispatched as efficiently as possible.

8. NRG is comfortable with NEMMCO making an assessment as to the timeframe to rectify a breach, but queries whether the AER itself is fully equipped to be the arbitrator in the case a participant disagrees with NEMMCO's timeframe assessment. This will nearly always be an engineering assessment and as such we would expect that the AER would use a suitable engineering based arbitrator to make this assessment.

9. NRG is comfortable with this approach as long as NEMMCO is required to assess the materiality of the breach when assessing the timeliness of the remedy. That is, if the breach is not at all material the participant should not be expected to have an expedited approach to the remedy which would most likely result in additional costs to the participant. This judgement should rest on technical and system security considerations alone, as outlined above.

10. NRG does not support this approach as it contradicts the intended move away from a strict liability approach. A breach and penalty regime should only rest on breaches of the

compliance program or in the event of a technical standard breach on the non remedy of the breach within the timeframe agreed and stipulated by NEMMCO, the AER and the participant (noting as above that the participant will have some appeal mechanism to oppose a timeframe if it is considered to be inappropriate).

11. It is important that NEMMCO share the relevant information with the AER in relation to alleged incidents of technical non-compliance. However, in line with the 'pyramid' of escalating enforcement measures, this should only usefully occur in circumstances where it appears a compliance program may have been breached, or where rectification of a notified issue of non-compliance has not occurred.

    It is also important to encourage early identification and notification of instances of non-compliance to support timely rectification, and to avoid perverse incentives which would discourage such reporting by a generator. This is also consistent with the recommended move away from strict liability towards an assurance based compliance regime.

    Routine reporting by NEMMCO at an aggregate level (eg annual summary reporting) of non-compliance notifications and rectification would also be consistent with this approach.

    NRG does not agree with the proposition of "potential" non compliance. Participants are either compliant or they are not - an assessment of potential non compliance will become problematic for both NEMMCO and the relevant participant. For example what is the intended consequence of a potential non compliance; certainly a participant should not be expected to remedy a potential non compliance issue as a non compliance has not actually occurred.

    Again, NRG is of the opinion that a more flexible approach should be adopted as detailed in recommendation 7 above.

12. NRG Flinders strongly supports the move away from strict liability for non-compliance with technical standards. The goal of any compliance program is to manage obligations and minimise the risk of non-compliance. However, such risk can never be eliminated entirely.

    Strict liability therefore serves no useful purpose in this context. Liability should instead revolve around conformance with an agreed compliance program, taking all reasonable measures to comply in accordance with the principles of good electricity industry practice - a standard which applies elsewhere throughout the Rules in relation to technical matters.

    Only after the technical standards framework has been improved, a fault based or assurance based approach has been adopted, and the standards themselves have been

comprehensively reviewed and revised can the question of penalties be meaningfully considered.

NRG Flinders does not believe the outcomes of such a review can be pre-empted at this stage, and is yet to be convinced that greatly increased penalties to the point where they are consistent with the rebidding penalties are either warranted or useful in the expanded and strengthened technical compliance framework being developed. Greater focus should instead be placed on ensuring compliance through the compliance program framework, rather than punishing instances of non-compliance. The Draft Report reflects favourably the APRA approach which states *"that as a regulator it aimed for negotiation of contraventions"* and *"it was therefore necessary that enforcement provisions provide an adequate incentive for this and to ensure that any agreed rectification will actually occur"*.

13. Subject to the specific comments above, NRG Flinders is comfortable with the range of actions proposed by the Commission and supports many aspects of the Draft Report. It is also supportive of the collaborative approach that the AER and AEMC have engaged in with NEMMCO and relevant participants to work towards an improved technical standards framework in the NEM. NRG Flinders does however have a number of concerns which it has detailed above and looks forward to continuing to work with the Commission to ensure a sensible and efficient outcome is achieved.

NRG Flinders appreciates the opportunity to share these views, and trusts that the above comments are helpful in setting the Final Report. Should you wish to discuss any of these matters further I can be contacted on (08) 8372 8726.

Yours sincerely

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