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John Tamblyn
Chairman
Australian Energy Markets Commission
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Dear John,

Performance standard compliance of generators

The Australian Energy Regulator (AER) welcomes the opportunity to respond to the Commission on the issue of whether it would be appropriate for the AER to be responsible for accepting or rejecting generators' compliance programs on performance standards.

The AER has very strong concerns with the proposition that the AER should approve or reject generators' compliance programs. In our view this would be bad policy.

It would result in significant additional costs to the sector for limited benefit, would compromise the AER's enforcement role and result in a net detriment to the NEM.

This submission sets out how compliance would be managed under the proposal put forward by National Generator's Forum (NGF), and then considers what the effects might be if the Commission's proposed approach was adopted.

Managing compliance under the NGF proposal

Under the NGF proposal, the Reliability Panel develops a template for generator compliance programs. The template defines "good electricity industry practice" for the purposes of the Rules, and hence provides certainty for generators as to what is required of their compliance programs. Generators must develop and maintain compliance programs in line with the template. A further feature of the proposal is that the template is regularly reviewed by the Reliability Panel in order to provide a continual improvement focus. The generator then has a

six month window to implement any changes to its compliance programs to reflect the new template.

As part of its compliance monitoring activities, the AER conducts spot audits of selected generators' compliance programs. This creates incentives for generators to have robust compliance programs in place, without the cost of examining every generator's compliance program.

If an incident occurs that calls into question compliance by a generator with its registered technical performance standards, the AER must determine whether enforcement action is warranted and, if action is warranted, the nature of the enforcement action. In forming a view on these matters, the AER would consider (among other things) the generator's compliance program, including whether the compliance program is consistent with the template developed by the Reliability Panel.

The NGF's proposal is consistent with recent amendments to National Electricity Law (NEL). The generators' compliance programs would take the form of a compliance program required under the Rules, as envisaged by section 64(e) of the NEL.

Effects of the Commission's proposed approach

Under the Commission's proposal, the AER would approve/reject generators' compliance programs. We understand that the AER would be required to compare the generators' compliance programs with the template developed by the Reliability Panel when it determines whether the compliance program should be approved or rejected.

The explanatory note issued by the Commission on 18 September 2008 indicates that the key objective of the Commission's proposed change is to ensure effective enforcement. The AER believes that the proposed change will achieve the opposite effect.

Effective regulation requires clear allocation of roles and responsibilities. Generators should be responsible for complying with technical standards. The AER should be responsible for monitoring whether a breach has occurred, and taking enforcement action in the event of a breach. Approval of compliance programs by AER would mix these roles and consequently diminish generator's accountability in relation to technical standards.

Even if it wanted to, the AER is unable to fetter any discretion it has under the NEL. That is, it cannot limit in advance the way it will exercise discretion in the future. The fact that it has approved a generator's compliance program will not limit the enforcement action open to the AER. In order to prevent generators from developing misplaced expectations that certain conduct will be protected from enforcement action, the AER will need to attach caveats to its approval of compliance programs. This will diminish the value of the approval from a generator's perspective in terms of providing regulatory certainty.

The AER may be perceived as having a conflict of interest, or at least, lacking objectivity if it is required to enforce a breach of the Rules in relation to compliance with the performance standards where it has approved the generator's compliance programs in advance. The AER

may also have cause for embarrassment if it approves a compliance program which is subsequently shown to be inadequate. Given the risk to its reputation, the AER is likely to take a conservative view when approving compliance programs. The result is likely to be increased cost to industry and stifling of innovation in compliance strategies.

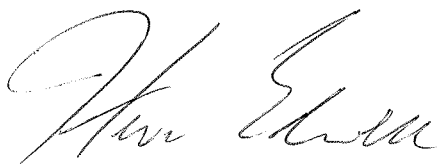
Accordingly, given the limited benefits and potential costs, we consider that the proposal to require the AER to approve generators' compliance programs would result in a net detriment to the NEM.

Further, if adopted, the Commission's proposal would give rise to a major additional function for the AER. There are more than 120 different generators and the approval process would require specialist engineering knowledge that does not sit well with the AER's existing skills set.¹

The role of the AER in relation to generators' compliance programs was the subject of extensive multilateral discussions. The position set out in the NGF's Rule change proposal has broad industry support, including the support of the NGF, the AER, and NEMMCO. The proposal also has the support of the Ministerial Council on Energy (MCE), who have commented that "Ministers noted the valuable work of the NGF in consultation with the AER and NEMMCO, in developing rule changes relating to [compliance with, and enforcement of] generator technical standards."² The NGF's process was also endorsed in the SA Minister for Energy's Second Reading speech on the amendments to the NEL.³

For these reasons, we urge the Commission to reconsider its position. I would welcome the opportunity to discuss this matter further.

Yours sincerely



Steve Edwell
Chairman

¹ At present, the AER engages consultants to assist when auditing technical standards.

² The Ministerial Council On Energy Communiqué Melbourne, 25 May 2007.

³ "The Ministerial Council on Energy... commented that it was appropriate and consistent with the overall market governance model for the NGF, in consultation with NEMMCO and the AER, to initiate a rule change proposal based on the Commission's recommendations through the rule change process." SA Minister for Energy's second reading speech on National Electricity Law (South Australia) (National Electricity Law — Miscellaneous Amendments) Amendment Bill, 27 September 2007, Pp 968-971.