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Dr John Tamblyn
Chair
Australian Energy Market Commission
PO Box H166
AUSTRALIA SQUARE NSW 1215

Dear Sir

**AEMC Draft Report on
Review of Enforcement and Compliance with Technical Standards**

The National Generators' Forum ("NGF") appreciates the opportunity to comment on the Commission's draft report on compliance with and enforcement of technical standards. The NGF welcomes the Commission's proposal for further reviews to overhaul the technical and performance standards regime. However, the NGF has a range of qualifications or counter-proposals to many of the preliminary recommendation's details.

This letter and Attachments A and B jointly form the NGF's submission and need to be read in conjunction. The NGF's comments addressing each of the draft report's recommendations are in Attachment A.

I would like to make two points providing important context for the positions the NGF has adopted and which should inform the application of the regulatory theory described in chapter four of the draft report.

First, it is critical to recognise that generators have very sound commercial reasons for desiring a secure electricity system. Generators must have a stable and predictable physical operating environment to make sensible plant and trading decisions. Should plant damage result from an insecure system, generators face lengthy and costly outages. The costs of repairs, of unwinding contract positions and of lost production revenue can be extremely high, in the order of millions of dollars. That is, generators have a compelling self-interest in properly maintaining and operating their plant and rectifying faults so that they can provide reasonable assurance of surviving a wide range of system events to contribute to overall security. The Commission should not forget this driver when its recommended series of reviews reaches the point of considering penalties.

Although the NGF recognises that infrequently a generator may receive a benefit following a performance standard breach, the probability of that being a planned outcome is so low as to be negligible. Generating businesses cannot be run successfully by mismanaging plant in the hope of unforeseeable events delivering inestimable benefits. Instead, generators seek to use the Market mechanism to optimise their revenue, which requires maximum plant availability so that managers have access to the widest range of price/volume options at any time. The NGF has the impression that some parties to this issue have forgotten this fundamental point.

Second, system security is the product of the actions and interactions of three groups – generators, performing as described in the preceding paragraphs, Network Service Providers (“NSPs”) and the National Electricity Market Management Company (“NEMMCO”). NSPs must deliver a system that can operate securely and provide adequate protections for their equipment to isolate system events. NEMMCO must operate the system to maintain security. None of these functions can be performed in isolation from the others, and, to obtain the best system security outcome, must be supported by a regime which promotes cooperation and open communication.

These points tend to support the NGF’s contention that further review of the regime should lead to a design in which most of the regime applies the compliance model approach while incorporating the capacity for an escalating regulatory response in the face of a clear danger to system security and or gross negligence by Participants.

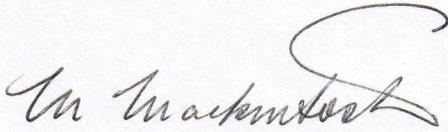
The NGF has formed considered views about how to implement this goal in relation to particular elements of the future regime. Generators support the proposal to shift from strict to fault-based liability. Strict liability is not consistent with the practical engineering issues inherent to power generation plant. The logical consequence of this point is that attaching liability to the standard itself is less effective than a regime in which liability attaches to the application of compliance programs which are designed to provide reasonable assurance of compliance with applicable performance standards. Where it is not possible to test for or otherwise show probable compliance, liability should attach to failures to rectify faults within specified times. Attachment B provides an example of how this outcome may be achieved by amending clause 4.15 of the Rules. The NGF recommends that this amendment should be implemented as a transitional measure.

The NGF considers that the reviews recommended by the Commission must be conducted in a particular sequence. The NGF believes that the steps of the recommended reviews ought to be:

- Examination of technical and performance standards and compliance programs to establish instruments which are grounded in sound engineering knowledge and practise;
- in parallel with and, crucially, informed by the examination of the preceding technical matters, re-consideration of the actions and, or instruments to which liability should attach and the form of liability; and
- towards the end of the Commission’s series of recommended reviews, in light of the design of the broader revised technical and performance standard regime a review, and if appropriate, re-setting of penalties. The penalty regime cannot be reviewed, let alone revised, until the content of the regime and forms of liability are determined – otherwise and penalties will lack a rationale and credibility in the industry.

Please do not hesitate to contact Mr John Boshier, the NGF's Executive Director, as generators look forward to discussing these matters further with the Commission.

Yours sincerely

A handwritten signature in cursive script, appearing to read "M Mackintosh". The signature is written in dark ink and is positioned above the typed name.

Malcolm Mackintosh
(Acting) Executive Director

**Amendments to Rule Clause 4.15 to Implement
Fault-based Liability Attached to Performance Standards Compliance Programs**

- 1 Clause 4.15(a)(1) - insert these words at the end of 4.15(a)(1):
", by complying with the obligations imposed on the Generator under clause 4.15(b)".
- 2 Clause 4.15(a)(2) - insert these words at the end of
4.15(a)(2): ", by complying with the obligations imposed on the Generator under
clause 4.15(b)".
- 3 Clause 4.15(a)(2) - replace the word "ensure" with "have the
objective of ensuring".
- 4 Clause 4.15(k) - insert the word "operating" between the words
"remains" and "in breach".
- 5 Clause 5.2.5(a) - delete the words "its connection agreement".
- 6 Clause 5.2.5(a) - insert these words at the end of the clause:
"to the extent and in the manner provided in Chapter 4 of the Rules".

National Generators' Forum

AEMC Draft Report on Review of Enforcement and Compliance with Technical Standards

Response to Draft Recommendations

(The recommendations are addressed in the order followed in the draft report's Summary of Recommendations on page 5.)

- **Item 1.** The NGF supports the broad process recommended by the AEMC to resolve performance standards for existing plant and is working with the National Electricity Market Management Company ("NEMMCO"), Network Service Providers ("NSPs") and the Australian Electricity Regulator ("AER") to that end. Generators are prepared to provide their connection agreements to NEMMCO provided that the requirement applies to only those provisions setting out technical performance obligations and not to matters which are commercial in confidence between the parties to those agreements.
- **Item 2.** The NGF supports the review in principle, and raises a number of issues which it considers should be assessed in that review.

The NGF considers that generators should nominate the performance standards for their plant and that those standards should be the actual sustainable capability of that plant. These standards should be couched in light of evidence obtained through the process of plant commissioning and should be able to be re-opened on the basis of experience with that plant over time. The sole restriction on performance standards for generating plant should be that standards below defined minima set in the Rules are not acceptable.

An externally driven increase in the performance standards of plant is not acceptable other than through commercial negotiations between generators, NSPs and NEMMCO. Generators in those circumstances are providing a service for which they incur costs and must be compensated. The review will, however, need to consider the definition and treatment of major overhauls of, or upgrades to, plant which a generator may undertake for other reasons yet which result incidentally in a higher performance standard capability for that plant.

The NGF considers that a secure system is the product of the actions and interactions of generators, NSPs and NEMMCO. Generators must have reasonable, adequate protections to enable them to survive a range of well defined system events so that the likelihood of an event being managed without endangering system security is maximised. TNSPs are responsible for delivering a system that can operate securely and for providing reasonable, adequate protections on their equipment to isolate system events. NEMMCO is responsible for operating the system to maintain security.

This raises an important NEM governance issue. Generators are concerned that NEMMCO is seen as a quasi regulator within the system security regime when it is in fact a key participant in that system and cannot be regarded as an independent or neutral party. The NGF recommends that not only generators, but NSPs and NEMMCO be subject to performance standard compliance regimes appropriate to their roles.

Consistent with this argument, it is not appropriate for NEMMCO to be a decision-maker on compliance programs for generators or NSPs as it is then placed in a position of conflict. The NGF considers that the role should be reassigned, probably to the AER noting that additional pertinent comments on this are made under items 4 and 5 below.

- **Item 3.** The NGF supports the recommendation for a review of the standards and for it to be conducted by the Reliability Panel. The range of membership on the Panel makes it the body most likely to have the capability of defining standards which promote security while being grounded in engineering practicality.
- **Items 4 and 5.** The NGF has significant concerns with the approach recommended by the AEMC.

The NGF supports the concept of guidelines for compliance programs. It is not supportive of the process described in the draft report whereby –

- the guidelines are issued by NEMMCO following consultation under the Chapter 8 procedures;
- generators and others are required to submit compliance programs to NEMMCO and the AER consistent with the principles in the Rules and the NEMMCO determined guidelines; and
- NEMMCO and the AER may reject a compliance program if they consider it either contains inadequate information or is not compliant with the Rules principles or the guidelines.

The NGF recommends a process in which –

- as noted under item 2, NEMMCO's operational system security role is recognised and understood so that it does not have a function of approving compliance programs;
- the principles in the Rules, expanded beyond describing the system security outcomes sought, address many of the matters now covered in the guidelines about how to achieve and provide (perhaps in a schedule) a menu of options for testing a range of technologies for compliance with applicable standards;
- this properly ensures that the AEMC sets the parameters for testing compliance with performance standards to ensure system security and that the AER is essentially confined to performing the regulatory role of enforcing those parameters;
- the Rules should establish that the expanded principles are a guide and that variations to accommodate technical differences are acceptable provided that achievement of the system security outcomes sought is not impeded and that the generator, NSP or NEMMCO provides supporting engineering or other evidence relevant to their role in the system;
- each generator, NSP and NEMMCO is responsible for developing its own compliance program within reasonable timeframes and is required to consult with the other parties as appropriate in developing that program, including providing them with relevant information, which also will assist cooperation and communication;
- the AER a) audits whether these parties have followed the process in the Rules to develop their programs and may require a party to revisit aspects of its program if the process has not been applied, and b) where the program varies from the testing methods outlined in the Rules, may require amendments to the program or further

- evidence to support arguments that the program will provide assurance of compliance, and may obtain independent technical advice to support its decision-making; and
- generators, NSPs and NEMMCO may seek arbitration on AER decisions in relation to their programs (using the process contained in the draft grandfathering Rule change).

Generators' compliance programs would be the vehicle for providing reasonable assurance that plant complies with applicable performance standards and to which liability for failures would apply (see item 12 below and Attachment B).

- **Item 6.** The NGF supports the recommendation with a qualification.

Clause 4.15(a)(3) presently requires immediate rectification of a problem and is inconsistent with the practical reasoning underlying 4.15(f), (i) and (j). The NGF considers that 4.15(a)(3) should be omitted or made subject to the process in (f), (i), and (j).

This view is consistent with the amendments to clause 4.15 proposed in Attachment B.

- **Item 7.** The NGF considers that existing clause 4.15(j)(2) is adequate. The recommendation is impracticable as the time to rectify a breach is primarily an engineering question which will include judgements about trade-offs between the speed of rectification and the durability of the repair work. Further, the provision is prospective about Market outcomes and subject to considerably more judgement and likely error than relatively narrowly focussed engineering assessment. That is, generators consider that NEMMCO is being asked to make an assessment about costs to the Market which inevitably will be incorrect and which draw it towards the role of an economic decision-maker rather than forming part of the role of a market and .system operator.
- **Item 8.** In key regulatory matters such as these, it is essential that the regulator not only be independent but that it is seen to be so. The NGF therefore considers that a much more preferable approach is to use independent experts appointed to a panel for the purpose of arbitrating a timeframe. Generators are concerned that the draft report's recommendation draws the AER into operational decision-making which may compromise its ability to determine impartially whether to pursue actions against Participants for breaches of the Rules.
- **Item 9.** The NGF supports the recommendation provided the new Rule ensures that NEMMCO is required to take into account the effect of the breach on its ability to manage the power system securely and the practicable rate of progress of rectification. It will not necessarily be the case that non-compliance with a performance standard will endanger system security. It is important to allow flexibility while ensuring that the decision-making power over secure management of the power system remains with NEMMCO.
- **Item 10.** This recommendation affects NEMMCO rather than generators and may be driven by desires for legislative tidiness and fairness of the application of the law so that breaches of clause 4.15 carry the same implication for NEMMCO employees as they do for the staff of other Participants. The NGF does not support the recommendation. Generators object strongly to the current civil penalty regime established by the National Electricity Law ("NEL") in which employees at relatively junior levels are exposed to significant financial penalties, moreover on the basis of the civil standard of proof. The

NGF therefore considers it is inappropriate as a matter of principle to extend the application of the current NEL provisions to NEMMCO's staff. Further, generators consider that the application of the NEL civil penalties in this way will serve only to reduce the cooperation and communication required to maintain system security.

The NEL's civil penalty arrangement is another example where the industry sees a resort to heavy handed legislative measures as a means of satisfying narrow political concerns rather than a consideration by decision-makers as to how the regime can support sound behaviours to reach sound outcomes.

- **Item 11.** The recommendation is problematic. What is "relevant", what is "potential" and what is the benefit of the recommendation? The NGF considers that NEMMCO should be obligated to report on matters where it believes a clear danger limiting its ability to manage the power system securely has been established or a Participant has failed to rectify a breach within a reasonable timeframe nominated by NEMMCO. This will promote cooperation and communication between the parties and enable them to focus on results.
- **Item 12.** The NGF supports the broad thrust of the recommendation in principle. In particular, generators welcome the Commission's preliminary view that there is merit in moving from strict liability to fault based liability. The NGF considers that the current regime of strict liability is not consistent with the engineering practicalities inherent to power generation. Consequences of this are that the regime is viewed by the sector as lacking in credibility and that other stakeholders may have highly unrealistic expectations of plant performance.

The NGF remains very concerned that the Commission may remain of the view that the only reasonable course of action is to retain the attachment of liability to the standards themselves, and that an event in breach of a standard will automatically lead to proceedings. In reality, generators – in common with the operators of any other machinery – cannot provide absolute assurance that equipment will not fail unexpectedly. The NGF submits that other stakeholders need to come to terms with this fact.

The NGF considers, in light of this point, that there is considerable merit in a regime in which liability attaches not to a breach of the performance standards themselves but to:

- failures to apply compliance programs in accordance with good electricity industry practise and thereby provide reasonable assurance of compliance with performance standards, or,
- where compliance with a standard cannot be tested or reasonable assurance otherwise provided, to failures to rectify faults within a reasonable period of time.

This regime will drive effective self regulatory behaviour by generators and cooperation with NSPs and NEMMCO to maintain system security. Attachment B shows how clause 4.15 could be amended to achieve this outcome as a transitional measure.

A liability regime built on these grounds would implicitly recognise that generating plant with highly diligent and skilled management cannot provide absolute assurance that equipment will not fail unexpectedly. The present regime of strict liability means that

well run businesses taking all prudent steps face the prospect of penalties, including damage to reputation, despite their efforts. Such a regime carries little credibility with those subject to it and has the potential to build an adversarial relationship between the parties who need to cooperate to maintain a secure system.

The NGF considers that there is an order in which this regime should be reviewed and outcomes determined, as follows -

- performance standards;
- compliance program expanded principles to be set out in the Rules;
- level of liability and to what instruments or actions it should attach; and
- penalties appropriate in light of the above.

The NGF suggests that, in practise, the first two issues can be managed in parallel and should be addressed first. The question of liability arrangements can be reviewed in parallel with the first two issues provided that the answer is well informed by the analysis of the first issues. On the matter of penalties, it is clear to the NGF these can be reviewed and determined only when the content to which they are to be applied is clearly formed. For example, sensible penalties can be set only when the nature of the offence is defined with precision and that requires the entire technical and performance standards regime, including the behavioural drivers on those parties subject to the regime, to be understood.