

Quarterly Compliance Report
July to September 2006

November 2006



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1 Introduction

On 1 July 2005, the Australian Energy Regulator (AER) assumed responsibility for compliance monitoring, reporting and enforcement in the National Electricity Market (NEM).

Section 15 of the National Electricity Law requires the AER:

- (a) to monitor compliance by Registered Participants and other persons with this Law, the Regulations and the Rules; and
- (b) to investigate breaches or possible breaches of provisions of this Law, the Regulations or the Rules that are not offence provisions.

In carrying out its monitoring functions, the AER collects and analyses information from Registered Participants and the National Electricity Market Management Company (NEMMCO). The AER ensures that, to the extent practicable, monitoring:

- (1) is consistent over time;
- (2) does not discriminate unnecessarily between Registered Participants;
- (3) is cost effective for the AER, all Registered Participants and NEMMCO; and
- (4) information is published, or otherwise made available to the market, subject to any confidentiality requirements.

This report summarises the results of the AER compliance monitoring activities during the period July – September 2006.

2 Compliance monitoring strategy

The AER monitors the operation and performance of the National Electricity Market (NEM), conducts special investigations in response to market outcomes and/or specific events and aims to encourage compliance by market participants.

The AER compliance monitoring program includes targeting a number of specific Rule provisions each year. These provisions relate to areas in the Rules where compliance concerns have been identified or where changes to the Rules have been introduced. The AER will target 24 Rules each year for review. The AER assesses compliance with the targeted provisions through examining all, or a sample of, relevant market participants' behaviour. **Appendix A** summarises the provisions targeted, investigations and rebidding inquiries instigated since December 2005.

The review process encourages market participants to maintain an ongoing compliance management focus by targeting specific provisions of the Rules and reviewing compliance. The AER also conducts a rolling program of reviews of participants' compliance strategies and plans. Those reviews are conducted cooperatively and involve one-on-one discussions with participants. The reviews provide the opportunity to engage participants and to discuss compliance strategies and critical challenges faced by the participant in discharging its obligations under the Rules.

The AER's approach to monitoring compliance relies, in the first instance, on comprehensive observation and reporting. During the compliance review process, the AER assesses the adequacy of compliance from the information provided by the Registered Participants and may review compliance with these obligations at regular intervals.

In the July - September quarter, the AER focused its compliance monitoring program on the Local Black System Procedures, established under clause 4.8.12 of the Rules and the settlement timing obligations of clause 3.15.16. A review of the obligations of ancillary service providers, following on from issues identified in the January – March quarter, was also undertaken with respect to selected Queensland ancillary service providers.

During the next quarter, the AER proposes to continue to review the obligations of participants with respect to ancillary service provision and in relation to planned network outages. The AER also proposes to review the registration provisions, in particular the use of intermediaries.

The AER is keen to hear from participants and other interested parties on any matters of compliance, in particular with respect to the specific areas targeted for review.

3 Compliance monitoring outcomes

As part of the compliance monitoring strategy, the AER aims to conduct one-on-one meetings with market participants each quarter. During the September quarter, the AER met with two market participants and NEMMCO to discuss compliance issues. These discussions focussed on the AER's investigation into the events of 31 October 2005 and the methods by which the participants manage compliance with the Rules.

3.1 Targeted provisions

Ancillary service provider obligations and responsibilities

The AER continued its review of ancillary service provider obligations and responsibilities. This quarter the AER focused on systems in place in Queensland, selecting 3 of the larger ancillary service providers.

Clauses 3.8.7A(k) and 4.9.9B set out the requirements and obligations placed upon providers of ancillary services to ensure that offers to provide ancillary services match the capability of the relevant plant, and that any changes as to the availability of such plant is made known to NEMMCO without delay.

Clause 3.8.7A(k) requires that:

“an Ancillary Service Provider that submits a market ancillary service offer must ensure that the ancillary service generating unit or ancillary service load, as the case may be, is at all times capable of responding in the manner contemplated by the market ancillary service specification.”

Clause 4.9.9B requires that:

“A Market Participant which has classified a generating unit or load as an ancillary service generating unit or an ancillary service load must, without delay, notify NEMMCO of any event which has changed or is likely to change the availability of a market ancillary service, or the capability of the generating unit or load to respond in the manner contemplated by the market ancillary service specification, as soon as the Market Participant becomes aware of the event.”

The AER wrote to three ancillary service providers, requesting a review, of the arrangements for compliance with the provision set out above. Participants were requested to provide the following information:

- Details of the process the service provider undertakes to ensure that its ancillary service units are at all times capable of responding in the manner contemplated by the market ancillary service specification.
- Details of the process the service provider has in place to ensure that NEMMCO is notified of any changes in availability or capability of its ancillary service units.
- Whether the service provider notified NEMMCO of any event(s) apart from through the normal market mechanisms, during the period July – September 2006, which changed the availability of a market ancillary service, or the capability of the unit to

respond in the manner contemplated by the market ancillary service specification in accordance with clause 4.9.9B of the Rules.

Review outcome

The AER reviewed participants' responses against the requirements of the Rules. The responses demonstrated that participants had the necessary processes in place to ensure compliance with the Rules with respect to the provisions reviewed.

Testing of ancillary service generating units

- Responses indicate that each of the ancillary service providers have testing systems in place to ensure that the nominated capability of their generating units is matched by the units performance.
- The ancillary service providers also perform tests to determine the actual performance of the generating units conformed to the offers made.
- One ancillary service provider stated that it ensures that all of its plant operators are aware of the ancillary service obligations and that they notify the Traders of any changes in availability.

Notification to NEMMCO

- Responses indicate that each of the ancillary service providers notify NEMMCO of the availability of the capability of the units via the market bidding systems.
- The ancillary service providers then provide any changes to the capability to NEMMCO through those same market systems.

External arrangements

- One ancillary service provider identified arrangements it has with an external contractor to provide it with a monthly report on frequency events, together with frequency and unit performance data to allow the provider to assess its ancillary service performance.
- One ancillary service provider has in place an arrangement with the relevant Transmission Network Service Provider (TNSP) to supply the ancillary service provider with high-speed data in the event of a system disturbance.

AER assessment

Based on the information provided by the participants, and the AER's assessment of that information against the requirements in the Rules, the AER is satisfied that the participants reviewed are aware of the obligations with respect to clauses 3.8.7A(k) and 4.9.9B of the Rules.

The AER will continue to monitoring the accuracy of ancillary service offers in conjunction with the monthly frequency and time deviation reports published by

NEMMCO to ensure that ancillary service providers continue to meet their obligations under 3.8.7A(k) and 4.9.9B.

Settlement payments by Market Participants

The AER targeted the obligations of Market Participants with respect to settlements with NEMMCO. This followed an earlier request to NEMMCO, which uncovered that since the beginning of 2006, there had been 14 instances where Market Participants had made late settlement payments.

Market settlement is the process by which financial payments, billing and settling for the amount of energy used and produced are made. NEMMCO administers the settlement of spot market energy transactions, reallocation transactions, ancillary service transactions and participant fees. All of these are cleared through NEMMCO on a scheduled settlement calendar with set deadlines

Prompt market settlement is crucial to the operation of the NEM. Any payment made after the 10.00am deadline can result in a deficit in the funds available for distribution by NEMMCO.

Timeliness in settlement provides confidence in the NEM to the financial market participants who supply credit support to Market Participants. The providers of this credit support can take comfort that all debts owing to or owed by the companies they provide to are cleared and that no penalties for late settlement will be forthcoming.

Clause 3.15.16 states that:

“On the 20th *business day* after the end of a *billing period*, or 2 *business days* after receiving a statement under clause 3.15.15, whichever is the later, and in accordance with the *timetable* each *Market Participant* must pay to NEMMCO in cleared funds the net amount stated to be payable by that *Market Participant* in that statement whether or not the *Market Participant* continues to dispute the net amount payable.”

The AER wrote to each of the eight Market Participants identified by NEMMCO. The AER sought information in relation to the following questions:

- what procedures the Market Participant has in place to ensure that the requirements of clause 3.15.16 are satisfied;
- how the Market Participant identifies late or inaccurate settlement; and
- how the procedures identified are monitored to ensure that compliance with clause 3.15.16 is maintained or improved.
- details of any unforeseen circumstances that have lead to settlement problems.

Review outcome

The participants' responses were reviewed against the requirements of the Rules. The AER noted that all of the participants have reviewed their internal processes and implemented additional processes to ensure compliance.

Compliance processes

- Each of the participants provided details of their internal processes to ensure compliance with the requirements of the Rules. A number of additional processes have recently been introduced to avoid late payments following the AER's inquiries. These include:
 - Entering payments into the Exigo and Austraclear settlement clearing systems the day before settlement;
 - Monitoring the transactions up to the settlement time the next day; and
 - Confirming with NEMMCO that settlement has occurred.

Banking communication processes

- The participants all pointed to banking errors as the primary reason for the late payments during the period. In each case since the inquiry, each participant has taken steps to ensure that such errors are avoided in the future.
- Each participant confirmed it had since communicated with its respective bank to ensure that those institutions are aware of the importance of the settlement deadline, and the obligations on the participants under the Rules.
- Most participants have in place notification systems with their banks so that where settlement has not occurred 30 minutes prior to the settlement cut-off, the participant will be made aware of this and can intervene to ensure all deadlines are met.

AER assessment

Based on the information provided by the participants, and assessment of that information against the requirements in the Rules, the AER is satisfied that the participants reviewed are aware of the obligations with respect to clause 3.15.16 of the Rules. Compliance strategies and plans have been improved to ensure better performance in this area in the future.

The AER notes that in all the cases examined, the delay in settlement was less than 10 minutes after the deadline. Often this was due to factors outside the participants' direct control. The AER is satisfied that the additional steps now in place will result in improved compliance with the Rules in this area.

The AER has established reporting arrangements with NEMMCO with respect to late settlements, and will continue to monitor this area for compliance with the Rules.

Local black system procedures

Black system procedures have been established to ensure that information is available to NEMMCO to assist in understanding the likely conditions and the capabilities of the power system following a major supply disruption. Clause 4.8.12(e) of the Rules, which came into effect in April 2006, requires NEMMCO to develop and publish guidelines for the preparation of local black system procedures in consultation with

generators and network service providers. The final guidelines were published in July this year. Clause 4.8.12(d) of the Rules requires generators to develop local black system procedures in accordance with those guidelines.

At the same time as publishing those guidelines, NEMMCO requested each generator to review and develop local black system procedures consistent with those guidelines and submit them to NEMMCO by 18 August 2006.

NEMMCO provided to the AER a list of all registered generators, and the extent to which those generators' listed capacity was covered by local black system procedures. The AER wrote to six of those generators, selecting those who had not submitted local black system procedures or whose coverage was very limited, to seek further information on their compliance with the guidelines and 4.8.12 of the Rules.

Specifically the AER asked the following questions:

- whether the participant has supplied NEMMCO with details of its local black system procedures;
- the approval status of any local black system procedures provided to NEMMCO;
- how the participant plans to proceed if it has not provided NEMMCO with details of its local black system procedures *or* it has received a request from NEMMCO to amend its procedures; and
- the implementation and review policies that the participant employs in regards to its local black system procedures.

Review outcome

The participants' responses were reviewed against the requirements of the Rules and NEMMCO's request for information.

Submission of local black system procedures

The AER review found that:

- Some of the participants had since submitted the relevant procedures to NEMMCO.
- The remaining participants were finalising the reviews of their procedures to fulfil their obligations. In general, those participants who were still reviewing their procedures were new owners of the relevant plant, and so had incurred delays in either modifying existing procedures or developing new procedures.
- In one instance the majority of the participant's plant was covered by local black system procedures, however one newly acquired unit was omitted due to a failure to notify the relevant officer of the requirement to submit procedures. A review of internal communications aimed to reduce the risk of such oversight in future.

AER assessment

Based on the information provided by the participants reviewed, and assessment of that information against the requirements in the Rules, the AER is satisfied that the participants are aware of the obligations with respect to clause 4.8.12 of the Rules and that appropriate procedures are in place or being developed.

NEMMCO has since advised that all outstanding draft black system procedures have now been submitted and are currently being reviewed.

The AER will revisit the black system procedures of clause 4.8.12, with NEMMCO following its review of the draft black system procedures submitted by participants and its broader system restart plan.

3.2 Jurisdictional derogations

Chapter 9 of the Rules preserves certain jurisdiction-specific arrangements. These are known as jurisdictional derogations and exempt participants from compliance with specified provisions in the Rules.

A series of chapter 9 derogations provide exemptions for Smelter Traders, Power Traders and Nominated Generators from complying with the Rules:

- to the extent that there is any inconsistency between the Rules and a contractual requirement under the relevant agreement; and
- any other specified exemption the jurisdictional derogations.

Power Traders must give notice to the AER of any act or omission which partly or wholly constitutes non-compliance with the Rules. In accordance with clauses 9.4.4, 9.12.3 and 9.34.6 of the Rules, the relevant participants have notified the AER that there were no matters of non-compliance for the September quarter.

AER assessment

The AER is satisfied that there were no instances where the actions of a participant classified as a Smelter Trader, Power Trader or Nominated Generator materially affected the efficient operation of the market during the quarter.

One participant notified the AER of a review of certain technical standards applying to its generating plant and the obligations under the chapter 9 derogations. This review may result in the removal of the participant's reliance on the Chapter 9 derogations. The outcome of the review will be reported to the AER once complete.

3.3 Technical standards compliance

The National Generators Forum (NGF) and NEMMCO, in conjunction with the AER and AEMC, have jointly determined a transition process to register the actual capability of all incumbent generators and to ensure all compliance programs are in place for those generators by 30 June 2007.

The intention of this transition process is to determine performance standards for those generators that do not yet have registered performance standards, and to reopen a limited number of registered performance standards:

- that are significant to system security where NEMMCO considers the registered standard is not the actual plant capability and needs to be reassessed due to significant system security requirements; or
- where the participant considers the registered standard is significantly above the actual plant capability.

On 4 September 2006 the NGF, with the support of NEMMCO, submitted to the Australian Energy Market Commission (AEMC) a Rule change proposal to establish arrangements for resolving the performance standards for generators that were connected, or in the process of connecting, at the date the current performance standards regime came into force in their region of the NEM. The Rule change proposal provides a process for determining the content of the standards, including reference to an independent expert where the generator and NEMMCO cannot agree. The proposal also requires that all performance standards be resolved by 30 June 2007.

On 31 October, the AEMC agreed to treat the Rule change proposal as a non-controversial Rule change. Subject to receiving any objections, and following the standard timeframe for an expedited process, the AEMC expect to make its (final) determination in respect of the proposal by early December 2006.

In the meantime, the NGF and NEMMCO are continuing to work towards having the matter resolved by the June 2007 deadline.

The AER will continue to monitor the progress of this matter.

3.4 Rebidding inquiries

The rebidding provisions of Clause 3.8.22(c) of the Rules require Scheduled Generators and Market Participants to provide:

- (1) all rebids to NEMMCO electronically unless otherwise approved by NEMMCO;
- (2) to NEMMCO, at the same time as the rebid is made:
 - (i) a brief, verifiable and specific reason for the rebid; and
 - (ii) the time at which the event(s) or other occurrence(s) adduced by the Scheduled Generator or Market Participant as the reason for the rebid occurred;

Clause 3.8.22(c) of the Rules requires a scheduled generator or market participant to provide information to the AER to substantiate and verify the reason for a rebid¹.

During the September quarter, the AER wrote to four participants seeking more information with respect to rebidding reasons and the obligation of clause 3.8.22(c)(2)(i). These requests sought:

- more information to clarify and substantiate a rebid reason;
- clarification of the use of the inflexibility provisions, specifically in relation to Testing;
- explanations of typographical and operator error in relation to rebid reasons; and
- explanations of failures to provide a timestamp, which represents the time at which the event(s) or other occurrence(s) adduced by the Participant as the reason for the rebid occurred.

AER assessment

The AER reminds participants of the obligations of clause 3.8.22(c)(2) and will continue to monitor compliance with this provision to ensure the requirements is fully satisfied.

4 Investigations

4.1 Investigation into the events of 31 October 2005

The market was significantly disrupted by a forced network outage on one of the major transmissions lines between Wallerawang and South Sydney on 30 October 2005 and the need for a further network outage to facilitate repairs the following day. There were a number of issues arising out of this event that required further examination. The AER completed its review of this event in late September and published its findings on 12 October 2006.

In summary, the investigation concluded:

- The AER will not take action for breach of the Rules with respect to this incident; and
- The AER will issue a compliance bulletin to the market outlining its understanding of the application of non-conformance provisions of clause 3.8.23 of the Rules and

¹ A rebid is defined in chapter 10 of the Rules as a variation to a bid or offer made in accordance with clause 3.8.22.

the responsibilities of participants to follow dispatch instructions as required by clause 4.9.8(a) of the Rules.

The AER will consider options to address the use of generator ramp rates for commercial reasons. In general, there are two possible approaches. One is to remove or reduce the incentive for generators to reduce the ramp rate for commercial reasons. The second is an administrative requirement for ramp rate bids to reflect actual generator capacity. The AER intends to develop and submit a Rule change proposal early next year. In considering this issue, the AER will assess whether other physical bid parameters may be used for commercial reasons, but to the detriment of power system security management.

The AER will seek undertakings from NEMMCO with respect to:

- its procedures for managing market or market systems failures and outage management;
- regularly reviewing all key constraints; and
- its obligations with respect to providing information to the market.

4.2 Investigation into the events of 22 March 2006

The AER imposed a civil penalty of \$20,000 on AGL Hydro Partnership over its use of the inflexibility and rebidding provisions of the National Electricity Rules with respect to its MCKAY1 generating unit on 22 March 2006.

The AER issued an infringement notice on 28 July 2006 alleging that AGL Hydro breached clause 3.8.22(c)(2)(i) of the rules by failing to provide a verifiable and specific reason for declaring the MCKAY1 generating unit as inflexible.

Physical operating conditions can prevent generators from increasing or decreasing output. The rules allow generators to notify NEMMCO of such circumstances using the inflexibility provisions. A generator that declares itself inflexible is treated outside the normal market arrangements, and must be dispatched by NEMMCO at the volume notified regardless of the price the generator offers that capacity.

Bidding inflexible may afford a commercial advantage to a generator over its competitors. The inflexibility provisions should only be used where abnormal operating conditions exist. If generators inappropriately declare themselves inflexible it has the potential to impact on the efficient dispatch of the market and threaten the safe and secure operation of the power system.

For these reasons, the AER carefully monitors and rigorously enforces this area of the rules to ensure that inflexible bids are used only exceptionally, and in response to genuine technical operating requirements.

AGL Hydro has paid the infringement penalty, and the AER's investigation of this matter is now closed.

4.3 Investigation into the events of 25 May 2006

On 25 May 2006 the No1 220 kV Busbar at Jeeralang Terminal Station tripped. The trip was initiated from Jeeralang Power Station Unit B1, although the power station was not operating on the day.

NEMMCO published a Power System Incident Report on 6 September 2006 outlining the events surrounding the trip. According to NEMMCO, the trip occurred following the return to service of a transformer that had been taken out of service to repair an oil leak. A third party contractor made the repairs.

During the repairs, a protection relay for the circuit was enabled. However, Ecogen Energy's operator reinstated the circuit prior to resetting this relay, resulting in the trip. The NEMMCO report stated that the power system "was not in a secure operating state for about 16 minutes", and recommended that Ecogen Energy review its maintenance procedures to avoid a similar incident occurring in the future.

Clause 5.2.1(a) of the Rules requires all registered participants to maintain and operate (or ensure their authorised representatives maintain and operate) all equipment that is part of their facilities in accordance with:

- (1) relevant laws;
- (2) the requirements of the Rules; and
- (3) good electricity industry practice and applicable Australian Standards.

The AER wrote to Ecogen Energy seeking further information with respect to the requirements of clause 5.2.1 of the Rules. Specifically the AER requested information to confirm:

- the party responsible for the work on the 10.5/5.5kV auxiliary transformer of unit B1, including preparing the equipment ready for service;
- the steps Ecogen Energy had taken following this incident with respect to reviewing its maintenance procedures as recommended by NEMMCO; and
- any other measures Ecogen Energy had instituted to ensure that such an event will not reoccur in the future.

AER assessment

Based on the information provided by Ecogen Energy, the AER is satisfied that Ecogen Energy has taken reasonable steps to increase awareness of its control room operators following this event, and to minimise the potential for recurrence. Following the incident, Ecogen Energy has improved control room labelling and retrained all relevant gas turbine operators. The AER is satisfied that the work carried out by the third party contractor had no impact on this incident.

Appendix A

Summary of AER targeted provisions, investigations and rebidding inquiries

Quarter	Rule provision	Description	Participants targeted	Outcome
December 2005	2.3.4(h)	Market Customer – Local retailers classification of connection points	9	Review complete
	7.1.4(a)	Obligations of Market Participants to establish metering installations	9	Review complete
	7.2.2(a)	Responsibility of Local Network Service Provider – metering installations	12	Review complete
June 2006	3.7A	TNSP - Market information on planned network outages	7	Review complete
	3.8.7A(k)	Market ancillary service offers	1	Review complete
	3.15.16	Late settlement payment by market participants – NEMMCO	1	Reporting arrangement established
	4.8.12	System restart plan and local black system procedures – NEMMCO	1	Review complete
	4.3.4	TNSP– General obligation to assist NEMMCO in its power system security obligations following the events of 22 March 2006	1	Review complete
	5.7.4	TNSP - Routine testing of protection equipment– following the events of 24 February 2006	1	Review complete
September 2006	3.8.7A(k)	Market ancillary services offers	3	Review complete
	4.9.9B	Ancillary service plant changes	3	Review complete
	3.15.16	Settlements payment by market participants	14	Initial review complete
	4.8.12	System restart plan and local black system procedures	6	Initial review complete
	5.2.1	Obligations of Registered Participants– following the events of 25 May 2006	1	Review complete
Investigations				
31 October 2005		Investigation into the loss of telecommunications capability; power system security; generator rates of change; conformance with dispatch instructions; dispatch and pricing; and information provided to the market.		Final report published on 12 October 2006
22 March 2006	3.8.19/3.8.22	Inflexibility rebidding - infringement notice issued to AGL Hydro		notice issued on 28 July 2006
23 May 2006		\$5000 report issued on 27 October 2006 – investigations continuing		work in progress
20 July 2006		\$5000 report – investigations continuing		work in progress

Rebidding inquiries*	Company	Date of event	Outcome
September 2005	Delta Electricity	12 July 2005	Review complete
	TRUenergy	7 July 2005	Review complete
December 2005	Macquarie Generation	1 December 2005	Review complete
March 2006	AGL	26 January 2006	Review complete
	NRG Flinders	16 February 2006	Review complete
	AGL Hydro	22 March 2006	Review complete
September 2006	Macquarie Generation	19 July 2006	Review complete
	Macquarie Generation	20 July 2006	work in progress
	Callide Power Trading	20 July 2006	Review complete
	Callide Power Trading	24 July 2006	Review complete
	National Grid Australia	18 August 2006	Review complete
	Tarong Energy	21 June 2006	Review complete
	Tarong Energy	24 August 2006	Review complete

* Rebidding inquiries are made in accordance with clause 3.8.22 (c) (3) of the Rules.