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Dear Dr Tamblyn

Compliance with technical standards

The following brief comments are submitted in response to the *Issues Paper* published by the Commission as part of the review of enforcement and compliance with technical standards under the National Electricity Rules (the Rules).

PIAC considers that compliance with and enforcement of the Rules is an issue of particular importance to the current process of reform of the national energy market. We very much appreciate the necessity of achieving an appropriate balance between the goals of regulation through the Rules and related instruments and the costs of compliance and the impact on consumer prices. Yet, we remain concerned that too little attention is being paid to critical aspects of the behaviour of participants in the energy market and the best mix of rights and obligations.

The limitation of the current review and the *Issues Paper* is that it does not address explicitly the quantum of costs involved in delivering improved compliance. That is, no cost-benefit analysis has been presented for consideration. It is not possible, then, for PIAC at this point to offer comments on the content of existing technical standards since we cannot assess the extent to which end-users might benefit from particular changes.

PIAC can, however, give in principle support to the notion that the Rules should include a mechanism for periodic review and change to technical standards. Such reviews should be undertaken on the basis of cost-benefit analyses. It must be stressed that PIAC does not necessarily accept the view of the former National Electricity Code Administrator (NECA) that the further development of the national market should lead to some standards being phased out. The Reliability Panel of the Commission could be the appropriate body to undertake these reviews of technical standards provided it was able to do so through a public process and had the resources needed to undertake the cost-benefit assessment.

The *Issues Paper* raises the question of whether market participants can be required to be fully compliant with all standards at all times. The Paper also notes that the cost of compliance may outweigh the benefits of reduced or avoided risk occasioned by failure to meet a particular standard. In our view, however, the key question is not, as the Paper suggests, whether it may be reasonable for a participant to be permitted to deliver less than complete compliance with the technical standards. Rather, the circumstances described on page 13 (where even rigorous testing may not deliver the certainty of full compliance) suggest to PIAC that technical standards may need to be written to take account of the inherent problem of delivering continuous compliance in relation to some equipment. That is, rather than reducing the requirement for compliance it may be reasonable for the technical standard to be modified so as to provide for a lower level of performance. Again, this approach ought to be based on an assessment of the relative costs and benefits of each approach.

The review also is considering the question of the scope of compliance and enforcement activities, for example by raising the question of the role of the AER in policing breaches of technical standards and the question of reporting of breaches. In looking to perhaps bolster the role of the Australian Energy Regulator (AER) and compliance generally the Commission could consider the introduction of penalties for market participants who experience non-compliance but fail to report it to either NEMMCO or the AER.

More broadly, the question in the *Issues Paper* of the scope of compliance monitoring poses a choice between reactive and proactive stances. That is, whether the AER should pursue an active approach to identifying and dealing with breaches of standards or instead rely on the development of a 'compliance culture' within market participants. The Paper also notes the different costs that may be involved in each of these approaches. While PIAC remains mindful that monitoring and enforcement should not be unnecessarily intrusive or intensive we believe an active approach to compliance is preferable. We note that in NSW the licence regulator (the Independent Pricing and Regulatory Tribunal) has chosen to pursue the path of a 'compliance culture' within the regulated businesses, an approach that we believe does not produce an appropriate level of transparency in relation to compliance or accountability for the regulated businesses.

Active monitoring leads to the question of appropriate penalties. The *Issues Paper* raises the possibility that penalties for non-compliance may be calculated on the basis of the costs imposed on end-users by a breach of technical standards. In turn PIAC would question whether losses suffered by end-users is the most appropriate measure of the seriousness of a breach. We raise this simply because the range of penalties appear to us not to be intended to provide compensation to end-users who suffer a loss as a result of a breach. Indeed, we are aware from experience with distribution services in NSW that compensation as a form of penalty for non-compliance is an exceedingly difficult area in terms of calculation of the penalty and allocating redress to individual end-users.

It is open to the Commission instead to develop a position on penalties as a deterrent to non-compliance. To achieve this is may be reasonable to take into account the potential for end-users to suffer from a breach of technical standards. However, we wonder whether it is appropriate for two breaches of the standards which may be very similar in nature or their impact on the supply system to attract different penalties on the basis of differences in their impact on end-users – for example because they occurred at different times of the day.

Accordingly we suggest it may be desirable to have penalties imposed on the basis of the nature of or type of breach.

Effective deterrence and the size of penalties is central to the final question raised by the *Issues Paper* of perverse incentives around breaches of technical standards where a market participant may in fact gain some material advantage from its own non-compliance. In fact, the issue here is not the matter of some gain but the extent or nature of that gain since non-compliance may have resulted from a decision by a market participant to, for example, make a saving on operational expenditure by failing to undertake necessary maintenance or replacement of key equipment. The task, then, for the Commission in the first instance and later for the AER, is to ensure that the range of penalties is sufficient to provide market participants with a stronger incentive to achieve compliance than to risk breaching the technical standards. Again, where possible the choice of incentives should take account of the costs and benefits of achieving absolute compliance with individual standards.

I trust these brief comments will assist the Commission in the conduct of this review.

Yours sincerely
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