



**EnergyAustralia**

LIGHT THE WAY

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Lodged electronically

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Dear Secretariat,

### **Proposed Classification of Tiers for the reform of the Australian Energy Regulator Civil Penalty Regime**

EnergyAustralia welcomes the opportunity to provide a submission to COAG Energy Council's (COAG EC) consultation on the Proposed Classification of Tiers for the reform of the Australian Energy Regulator (AER) Civil Penalty Regime (Current Consultation).

EnergyAustralia is one of Australia's largest energy companies with approximately 2.5 million electricity and gas accounts in NSW, Victoria, Queensland, South Australia, and the Australian Capital Territory. We also own and operate a multi-billion-dollar energy generation portfolio across Australia, including coal, gas, and wind assets with control of over 4,500MW of generation in the National Electricity Market (NEM).

EnergyAustralia acknowledges the extensive background to the Current Consultation including previous consultation by COAG EC and findings by the ACCC in its Retail Electricity Pricing Inquiry. We refer to our submission in response to COAG EC's 2018 consultation on the AER Powers and Civil Penalty Regime.<sup>1</sup> We maintain our views in that submission particularly around the general increase to the maximum civil penalty amounts. Specifically, EnergyAustralia does not consider an increase to civil penalties is justified, in circumstances where EnergyAustralia is not aware of evidence of widespread or serious disregard for the law.

The focus of this submission is on the Decision Matrix and Concepts table proposed in the Current Consultation. Together, these documents set out the Framework that has and will guide the Minister's classification of the current Civil Penalty Provisions (CPPs) and CPPs prescribed in the future. In summary, our key points are:

- The Framework appears to be a "blunt" tool. It assumes that if a CPP is classified under a "Sub-concept" it then has a certain level of harm which aligns to a pre-determined penalty tier. Rather than, considering each CPP individually and the consumer harm or impact to the market that would likely flow from a breach of that CPP, and then assigning a penalty tier that is proportionate to that harm.
- We submit that the Framework be changed so that the Minister can flexibly depart from the pre-determined tier to assign a more appropriate tier; or that a different framework be developed which assesses each individual CPP on a case by case basis, and allows for the Minister to assign

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<http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/Energy%20Australia%20submission.pdf>

any penalty tier from the start. In either case, the appropriate penalty tier should be determined considering:

- The principle of proportionality – the punishment should “fit” the offence or contravention. Proportionality should be measured relative to the level of consumer harm, financial gain, or impact on the market.
  - The nature of the obligation, where only protective (rather than administrative) provisions that either involve an element of culpability/intent should be classified as Tier 1 or 2.
  - whether the obligation is clearly defined, so that a prudent regulated entity would clearly understand when it is, or is not, in breach (i.e. would pass a "bright-line test"). Only clearly defined CPPs should have a Tier 1 classification.
- We emphasise that it is important to classify the current and future CPPs appropriately and proportionately across the three tiers. This is because the different penalty tiers may serve as a signal to regulated entities of the areas which they should allocate their compliance resources to. If there is an over-classification of CPPs into the Tier 1 category, this could result in regulated entities over-allocating resources to compliance with those obligations.
  - We strongly suggest that any consideration to change the Framework or make a different framework should not be rushed and should involve more consultation.
  - We set out examples of the proposed classification of individual CPPs to illustrate either issues with the Framework or issues with the individual classification of CPPs, or both.
  - The high percentage of proposed Tier 1 classifications across the current CPPs may have perverse effects on the AER’s breach self-reporting regime. This is because regulated entities with the strongest controls to detect non-compliance are more exposed to significant penalties (compared to businesses that have weak detective controls or effectively no controls at all, or who fail to report their breaches). Classification of a higher number of Tier 1 CPPs than what is necessary would compound this effect. This can be minimised and avoided to the greatest possible extent, by ensuring any classification of individual CPPs as Tier 1 is appropriate and proportionate to consumer harm and impact on the market.

If you would like more information or would like to discuss any matters set out in this submission, please contact me on 03 8628 1548 or [Selena.liu@energyaustralia.com.au](mailto:Selena.liu@energyaustralia.com.au).

Regards,

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## Submission

### 1. Framework is a “blunt” tool

COAG EC is seeking feedback on whether the Framework provides sufficiently clear direction about which penalty tier applies and any improvements to the Framework.

We note that the *Statutes Amendment (National Energy Laws) (Penalties and Enforcement) Bill 2020* (the Bill)<sup>2</sup> does not contain any provisions which require the Minister to have regard to the Framework in determining the penalty tier that applies to a CPP provision. Rather, this is described at a very high level in the Consultation Guide only.

Our key concern with the Framework is that it could result in disproportionate maximum penalties for individual CPPs. This is clear when the proposed classification of the current CPPs (which is based on the Framework) is closely analysed.

The main deficiency with the Framework is the lack of flexibility due to the pre-determined classification of “Sub-concepts” into the three penalty tiers. The box below sets out our understanding of the application of the Framework, starting with the individual CPP and ending at the applicable tier.

Individual CPP > **Sub-concept** > **Concept** > **Tier**

There appears to be two parts:

- First, the Minister has discretion to classify each Individual CPP into the Sub-concept category (these are the dot points listed under Concept definition in the Concept table). The Minister considers each CPP in a “flow down” approach, starting with the Sub-concepts in Tier 1 to see if the CPP fits into any of them, and then moving to Tier 2 to repeat the same process. If after that process neither Tier 1 nor 2 apply, then Tier 3 applies by default.
- Second, where the Minister decides the CPP falls under a Sub-concept category then the pre-determined Tier 1, 2 or 3 classification applies. This means that after an individual CPP is classified into a Sub-concept the pre-determined tier applies. (i.e. the steps in bold in the box are “fixed”).

In our view, different individual CPPs falling under the same Sub-concept may result in different levels of harm, possibly to a significant extent where a different tier should apply.

For example, COAG EC proposes that 27 current CPPs will fall under the Sub-concept - “Reduction of consumers’ fundamental right to access essential electricity and gas services”. This category only exists under Tier 1. There is no similar category under Tier 2 or Tier 3.

Comparing these 27 CPPs, there are different levels of harm. A distributor failing to provide a connection service to the customer would cause significantly more harm, compared to a retailer’s failure to publish standing offer prices (section 66 and section 23(1)) of the NERL respectively). However, as both are classified under the same Sub-concept they attract the same Tier 1 classification. The only alternative option is under the first part of the Framework, where the Minister could decide that the CPP should not be classified as “Reduction of consumers’ fundamental right to access essential electricity and gas services” (and it is unclear whether the Minister can do this where the obligation logically only falls under that Sub-concept category). The Minister’s consideration

<sup>2</sup>

[https://www.legislation.sa.gov.au/LZ/B/CURRENT/STATUTES%20AMENDMENT%20\(NATIONAL%20ENERGY%20LAWS\)%20\(PENALTIES%20AND%20ENFORCEMENT\)%20BILL%202020.aspx](https://www.legislation.sa.gov.au/LZ/B/CURRENT/STATUTES%20AMENDMENT%20(NATIONAL%20ENERGY%20LAWS)%20(PENALTIES%20AND%20ENFORCEMENT)%20BILL%202020.aspx)

would then flow down to Tier 2, and because there is no similar topic under Tier 2, it would likely default to Tier 3. There is no flexibility to change the CPP from a Tier 1 to Tier 2 classification.

In this way, the Framework appears to be a “blunt” tool. It assumes that if a CPP is classified under a Sub-concept it then has a certain level of harm which aligns to a pre-determined penalty tier. Rather than, considering each CPP individually and the consumer harm or impact to the market that would likely flow from a breach of that CPP, and then assigning a penalty tier that is proportionate to that harm.

The current design of the Framework could lead to an inappropriate penalty tier applying to a CPP and disproportionate maximum penalties.

## **2. Changes to the Framework or a different framework is required**

We submit that the Framework be changed so that the Minister can flexibly depart from the pre-determined tier to assign a more appropriate tier; or a different framework be developed which assesses each individual CPP on a case by case basis and allows for the Minister to assign any penalty tier from the start. In either case, the appropriate penalty tier should be determined considering:

- the principle of proportionality – the punishment should “fit” the offence or contravention. Proportionality should be measured relative to the level of consumer harm, financial gain, or impact on the market. Where the breach of the CPP would likely result in more detriment to these factors, then a higher tier should apply.
- The nature of the obligation, where only protective (rather than administrative) provisions that either involve an element of culpability/intent should be classified as a Tier 1 or 2. Although some administrative requirements are identified as Tier 3, we consider there are still more CPPs that are currently proposed as Tier 1 and 2 but should be classified as Tier 3. We identify these CPPs in the next section.
- whether the obligation is clearly defined, so that a prudent regulated entity would clearly understand when it is, or is not, in breach (i.e. would pass a “bright-line test”). Only clearly defined CPPs should have a Tier 1 classification.

This is particularly important in a delegated rule-making environment that applies to the National Energy Rules, where an expedited rule-making process has been adopted to reflect the fast changing nature of energy regulation, but also means the drafting style is less formal, and in some cases less precise, than the drafting style of experienced Parliamentary Counsel.

This issue applies to an even greater extent to the Australian Energy Regulator (AER) guidelines, where the guidelines do not have the same multiple steps of the rule-making process and where drafting regulation is not the AER’s core function. In our experience, the drafting style can sometimes be very informal and at times unclear. We consider that CPPs that are an obligation to comply with an AER guideline should not be classified as Tier 1 as a general principle. We provide specific examples below.

We recognise that the AER’s Compliance and Enforcement Policy (under which civil proceedings are only one enforcement option), and the Court’s role in determining the level of penalty (having regard to certain matters) play an important role to ensure proportionate outcomes. However, even considering these roles, for some individual CPPs the proposed tier appears grossly disproportionate even when considering the most serious breach. We note that 52% of the current CPPs across all the National Energy Laws and Rules are characterised as Tier 1, compared with 35% and 14% for Tier 2 and 3. This weighting towards Tier 1 and Tier 2 classification is the most pronounced across the retail obligations (NERL and National Energy Retail Rules (NERR)), with 60% being proposed to be classified as Tier 1, and 30% and 10% as Tiers 2 and 3.

In the Consultation Guide, COAG EC notes that the overarching purpose of a civil penalty regime is to promote the public interest in compliance with the law. This is achieved through the imposition of penalties which are sufficient to deter contravening behaviour.

EnergyAustralia believes that the existing penalties already provide sufficient deterrence to breaches, in addition to the negative reputational impacts experienced by retailers who breach the National Energy Laws and Rules. We are also unaware of any findings that retailers approach compliance differently based on the theoretical penalties that could apply to a particular breach, but we recognise that this might change in response to the three tier penalty approach.

The different penalty tiers may serve as an important signal to regulated entities of the areas which they should allocate their compliance resources to, where compliance resources are scarce and finite. That is, Tier 1 obligations should attract a higher level of compliance resources compared to Tier 2 and Tier 3 CPPs because of the higher penalty that applies to Tier 1 CPPs (which should reflect that breaches of Tier 1 CPPs result in the greatest consumer harm or adverse impact to the market). This signal further highlights the significance of classifying the CPPs into the three different tiers in an appropriate and proportionate manner (as discussed above). If this does not occur and there is an over-classification of CPPs into the Tier 1 category, this could result in regulated entities and regulators over-allocating resources to compliance and monitoring activities for those obligations. This of course would not reduce the importance of regulated entities ensuring appropriate resourcing for compliance with all obligations.

We also consider there are other ways to improve compliance within the industry in addition to the civil penalty regime, such as industry engagement to better understand the barriers to achieving total compliance, regularly reviewing regulatory requirements to ensure that they still reflect current practice and consumer needs, and simplifying and harmonising the regulatory framework across jurisdictions.

Separately, we strongly suggest that changing the Framework or developing a different framework should not be a rushed process and should involve more consultation with industry and the Australian Energy Market Commission, Australian Energy Market Operator, and the AER. This is particularly important considering the maximum civil penalty amounts proposed for Tiers 1 and 2. If there are concerns around delaying other aspects of the Bill, it might be possible to enact the tiered penalty structure, but only if a Tier 3 classification could be applied as a default approach to all current CPPs, until a Framework that is fit for purpose is developed.

Below we set out examples of the proposed classification of certain CPPs to illustrate either issues with the Framework or issues with the individual classification of CPPs, or both.

### **3. Examples of proposed classification of current CPPs**

#### **National Energy Retail Law and Rules**

##### *Section 24 and 37 of the NERL*

Section 24 of the NERL specifies that:

- “(1) A retailer must—
- (a) present its standing offer prices (including any variation of those prices) in accordance with the AER Retail Pricing Information Guidelines; and
  - (b) without limitation, present those prices in accordance with those guidelines when publishing, advertising, or notifying the AER of those prices or any variation.

- (2) The retailer must present its standing offer prices (including any variation of those prices) prominently on its website and in any other relevant material provided by the retailer in accordance with those guidelines.”.

Section 37 is the equivalent provision for market offer prices. Both section 24 and section 37 of the NERL are about the presentation of electricity and gas prices in publishing, advertising, or notification to the AER (for the purposes of the AER’s Energy Made Easy website).

Both sections require that the presentation of prices must comply with the AER *Retail Pricing Information Guidelines* (RPIG) and are classified as “Reduction of consumers’ fundamental right to access essential electricity and gas services” which is a Tier 1 Sub-concept.

As a first issue, it is difficult to link these sections which are about presenting prices to the fundamental right to access energy and we query whether this categorisation is appropriate. However, even accepting this categorisation, the RPIG is an AER guideline which deals with lower level, administrative obligations. For instance, one obligation in the RPIG is that a retailer must provide energy pricing to the AER for the AER’s Energy Made Easy website and:

“the unit price for electricity and/or gas be, expressed in cents per kWh or cents per MJ [and] must be labelled using the word ‘usage’”.<sup>3</sup>

EnergyAustralia considers that it would be grossly disproportionate if a breach of the above requirement, which would result in very little consumer harm, ever attracted a maximum penalty of 10% of a corporation’s annual turnover. Even when considering a very serious breach of section 24, such as a complete failure to submit required data to the AER, it is still very difficult to envisage a court imposing a penalty of that magnitude, where the customer harm is that a retailer’s plans are not available on EME. This example highlights that the Framework as applied to the current CPPs results in disproportionate outcomes.

#### *Section 282 of the NERL*

Another example is section 282 of the NERL. Section 282 is proposed to be classified as “Failure to comply with specific notices or requests from a regulator” – a Tier 1 Sub-concept. This obligation requires a regulated entity to submit to the AER certain performance data in the manner and form required by the AER’s *Reporting Procedures and Guidelines*. One obligation in those Guidelines requires retailers to report on the “Number of customers on a retailer’s hardship program” in their quarterly report.

We consider it disproportionate that this administrative, low level obligation could attract a Tier 1 penalty, when there is minimal customer harm and regulated entities can rectify the breach by re-submitting reports. From our experience, breaches of performance reporting arise due to the complexities in aligning retailer data with regulatory requirements (which differ across jurisdictions) and they typically do not involve any culpability or malintent. Again, this example demonstrates our concerns with the Framework.

Both examples above also involve obligations which deal with compliance with an AER guideline. EnergyAustralia has approached the AER many times to clarify the intent and meaning of both guidelines. The obligations in these AER guidelines would not meet the “bright-line” test – retailers may not be able to determine when they are or are not in breach.

The following CPPs would more appropriately be characterised as “Requirements relating to the provision of notices or information to customers” (Tier 3), where they are proposed to be Tier 1 and 2 categories:

- Rule 48A(1) Retailer must notify MRC of benefit change, is classified as Tier 2 “Consumers not being informed of their rights” when this obligation does not relate to a consumer right.

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<sup>3</sup> Paragraph 33 a, <https://www.aer.gov.au/system/files/AER%20Retail%20Pricing%20Information%20Guidelines%20-%20Version%205.0%20-%20April%202018.pdf>

- Rule 46(4) Notice of tariffs and charges, is classified as Tier 2 “Security deposits or billing disputes” when this obligation does not directly relate to security deposits or billing disputes. We also note the Tier 2 classification is also inconsistent with the classification of sub-rule 46(4A) (the same Rule) as Tier 3.

## National Electricity Law and Rules

EnergyAustralia considers that the CPPs with the proposed classification of Tier 1 “Supply Security and Reliability” should be reviewed entirely in view of the impact that a breach of the CPP could conceivably have on the security or reliability of the electricity market. This is particularly the case for CPPs in Chapters 2, 3 and 4 of the *National Electricity Rules*. We recommend that COAG EC review these classifications with AEMO to understand the highly technical nature of these CPPs and the impact of a breach of these CPPs on the market and energy system.

### *Rules 2.2 to 2.7*

Rules 2.2 to 2.7 set out the Registered Participant categories and requirements which a person must satisfy to be registered by AEMO. Many of the CPPs in Rules 2.2 to 2.7 require compliance with terms and conditions imposed by the Australian Energy Market Operator. Some of these terms and conditions are minor and administrative in nature, and non-compliance with them would have a negligible effect on the market.

### *Rules 3.7B(b) and 3.8.17(e)*

Self-commitment and de-commitment decisions by generators (Rules 3.7B(b) and 3.8.17(e)) are classified as Tier 1, when breaches of these obligations are likely to result from inadvertent conduct. There is also a high frequency of the breaches which are quickly resolved via cooperation with AEMO. To classify these as Tier 1 could undermine the practical relationship fostered between market participants and AEMO to resolve issues.

### *Rule 4.10*

Rule 4.10.2(b)-(c) requires a Registered Participant to observe the requirements of the relevant power system operating procedures and has a Tier 1 penalty. We note for some generators, non-compliance with the power system operating procedures, would have very minimal impact on the electricity market and/or system security due to the size of the generator involved.

### *Rule 4.9*

Rule 4.9.3A(c) requires that a market participant who has submitted a market ancillary service offer must ensure that appropriate personnel or electronic facilities are available at all times to receive and immediately act upon dispatch instructions issued by AEMO. The nature of this requirement, particularly in relation to personnel, sets a very high threshold which may be technically breached with no practical effect. While we recognise that this is important, the breaches of this requirement should only attract a Tier 1 maximum penalty when the breaches are material and have an impact on the ancillary services market.

Rule 4.9.4(b) requires that a scheduled or semi-scheduled generator must not adjust the transformer tap position or excitation control system voltage set-point except in accordance with certain conditions. Failure to meet this obligation is unlikely to have an impact on system security, based on the extent of the tap change and the generation unit involved.

We also make the broader comment that imposing a Tier 1 classification disproportionately, for example regarding ancillary services obligations, may have the effect of disincentivising participants in offering those services, or entering those markets.

## National Gas Law and Rules

### Rule 636

Rules 636(2) and 636(4) have a Tier 2 classification which appears disproportionate given they are lower level administrative publication requirements regarding standard Operational Transportation Service Agreements (OTSAs). Rule 636(4) requires a transportation service provider to inform a prospective secondary shipper of information that would complete an incomplete standard OTSA request within 5 days. We consider it would be disproportionate that a \$1.435million penalty could apply to this timeframe obligation.

#### 4. Other issues

### High proportion of Tier 1 CPPs and effect on self-reporting regime

The high percentage of proposed Tier 1 classifications across the current CPPs may have perverse effects on the AER's breach self-reporting regime. The self-reporting regime is contained in the AER's *Compliance Procedures and Guidelines* which applies to the NERL, NERR and National Energy Retail Regulations (Compliance Guidelines). The Compliance Guidelines require regulated entities to report "any possible breach that the regulated entity believes is reasonably likely to occur or to have occurred" for specified obligations. Comparing the reportable breaches under the Compliance Guideline and the proposed classification of current CPPs, 21 of the 70 proposed Tier 1 CPPs are also reportable breaches.

The self-reporting regime could arguably result in regulated entities with the strongest controls to detect non-compliance being exposed to the most significant penalties (compared to businesses that have weak detective controls or effectively no controls at all, or who fail to report their breaches). While this is the case now regardless of any changes to the AER's civil penalty regime, the effect is compounded when there are more Tier 1 CPPs as the maximum penalties that could be imposed for a self-reported breach will be significantly higher.

We note that self-reporting regimes apply to other regulated industries, for example AUSTRAC requires self-reporting of breaches of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act). While very high maximum penalties apply to breaches of the AML/CTF Act - \$21 million - the potential maximum penalties of 10% annual turnover under Tier 1 could be significantly higher for some corporations, which means greater negative impacts to the self-reporting regime in the energy sector.

The above outcomes can be minimised and avoided to the greatest extent, by ensuring any classification of individual CPPs as Tier 1 is appropriate and proportionate to consumer harm and impact on the market (as discussed above).

### Multiple breaches per course of conduct

We also observe that with the increase to the maximum civil penalty amount and the high percentage of Tier 1 classification of the current CPPs, the issue around the maximum civil penalty amount being calculated per contravention, becomes more apparent.

One event such as an omission in scripting or on a letter template, may result in thousands of breaches. If the court could impose penalties per contravention, it could result in an astronomically high theoretical maximum penalty amount.

As a general principle, we do not think it is fair or appropriate for retailers to potentially be exposed to multiple Tier 1 penalties for the same conduct or behaviour. We consider that a proportionate and fair way to deal with this issue is to recognise in the National Energy Laws that the maximum penalty applies to a course of conduct (where one course of conduct may result in multiple contraventions) instead of applying to each contravention. Alternatively, the maximum civil penalty could be capped in some manner. Similar issues arose when the *Spam Act 2003* was introduced,

and concerns were raised about the theoretical maximum penalties being calculated per contravention or per email. Sections 25(3)(b) and 25(5)(b) of the *Spam Act 2003* contain a mechanism which effectively caps the maximum penalty where for a particular day there has been two or more contraventions of a CPP. Or alternatively, the Tier 1 penalties could be reserved for deliberate, wilful, or repeated contraventions of CPPs that have the greatest effect on consumer harm or impact to the market.