

AGL submission: Proposed Classification of Tiers for the reform of the AER Civil Penalty regime

The three-tier civil penalty framework will amend the current civil penalty regime for the NEL, NGL and the NERL (National Energy Laws). In order for the new penalty framework to apply to the current civil penalty obligations, the relevant respective regulations under the National Energy Laws will need to be amended to re-classify the civil penalty provisions to the appropriate penalty tier.

The concept table draws heavily on the National Energy Laws objective clauses. While these are an appropriate framework for assessing rule changes and guiding administrative decision-making functions it is not clear that they are particularly helpful in determining whether higher maximum penalty amounts would be beneficial, or the appropriate level of maximum penalty amounts to assign to particular provisions.

The National Energy Laws are quite different from the many economy wide principles based competition and consumer protection provisions of the *Competition and Consumer Act* administered by the ACCC. The National Energy Laws set out highly detailed industry specific requirements at a granular level. For example, they largely prescribe the market mechanisms and system requirements and are of course integral to the achievement of the energy objectives.

However, there are limited incentives, if any, for participants to seek to circumvent the majority of these obligations. In many cases, given the granular requirements form part of an interrelated regulatory framework there are limited circumstances, if any, where a contravention would result in customer harm. Indeed, the desire of participants to comply, even in the absence of higher penalties, is borne out by the paucity of case law on them, despite the fact that they are technical and often open to different interpretations.

Taking a penalty regime developed for different provisions in a different context and retrofitting it to the National Energy Laws risks unintended detrimental consequences including reduced co-operation between industry participants, regulators and the market operator, and does not have any clearly identified benefit.

We suggest that:

- the assessment criteria should more clearly take into account the level of penalties which are necessary in order to achieve appropriate levels of deterrence against behaviour aimed at circumventing obligations;
- should the decision matrix continue to assess the potential impact of a breach of a civil penalty obligation on the National Energy Objectives, it should do so in combination with an assessment of the extent to which higher maximum penalties would be beneficial to achieve appropriate deterrence;
- the classification decision matrix should be reversed such that the default position is that penalties remain the same and are only adjusted if there is a need to change. As noted below this approach would be consistent with the finding in the original 2013 review and the subsequent COAG EC SCO consultations. Under the current proposed approach, the tier 1 classification has inadvertently become a default due to the combination of an overly broad description of tier 1 provisions in the concept document and the trickle down approach to classification, under which provisions are not even considered for tier 2 or 3 if they are initially assigned to tier 1.

We discuss these points in more detail below.

The purpose of the higher tier penalty framework

The purpose of the current consultation is to determine how the civil penalty provisions should be reclassified given the purpose of the amended penalty framework. The consultation paper includes a draft decision matrix based on ‘concepts’, or in effect criteria to assign the penalty tier classification. These concepts are intended to be derived from ‘key themes’ of the national energy objectives as set out under the National Energy Laws.

Previous COAG SCO consultations regarding National Energy Laws penalty changes, have noted that in order to warrant a higher civil penalty amount for breach of a provision, the consequences of a breach of that provision should be quantitatively or qualitatively more serious than a breach of a provision attracting a lower penalty.

A court may take the maximum penalty into account when considering an appropriate penalty given the circumstances of the breach.

The proposed trickle-down assessment, concept table and decision matrix, is a material departure from the original purpose of the higher civil penalty tier framework. As detailed below, the matrix significantly broadens the scope of provisions that would be subject to tier 1 penalty provisions. This is not consistent with the original concept of elevating some key provisions of the NEL, NGL and NERL to Tier 1 penalties, which was the concept articulated as the basis for this reform.

Specifically, the 2013 review stated:

*“on balance we consider the **current structure and level of penalty rates to be largely appropriate** for the purpose of the National Energy Laws. This is so having regard in particular to the wide range of legislative and regulatory instruments to which the civil penalty regime applies and the objective of maintaining a simple and flexible regime that supports the continued development of the energy regulatory framework with a high degree of delegated rule-making power ...*

*At present the only provision of the National Laws that can be subject to the higher \$1 million penalty level is breach of a rebidding civil penalty provision. We consider there may be a **limited number of additional provisions** of the National Laws and Rules that could appropriately be subject to this higher maximum”¹*

The COAG EC SCO Consultation Paper in June 2018 referred to a ‘targeted’ review to determine whether there are any provisions that should attract higher maximum penalties.

¹ Review of Enforcement Regimes under the National Energy Laws, Report Prepared for the Standing Council on Energy and Resources, Nov 2013, p 9, <http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/Review-of-Enforcement-Regimes-under-the-National-Energy-Laws-Final-Report.pdf>

Specifically, it stated,

*“The 2013 Enforcement Review recommended conducting a **targeted review** of the civil penalty regime to determine **whether there are any specific additional provisions** under the laws, rules or regulations that should attract the higher maximum penalty rate...*

The Council noted that a **targeted review** would aim to identify:

- which **specific provisions, if any**, should attract the highest maximum penalty level;
- any unintended consequences from applying maximum penalty levels to **some provisions**.²

The COAG EC SCO Explanatory Note published alongside the bill introducing the three tiered penalty approach observed that:

*“With some exceptions, existing civil penalty provisions will be subject to the bottom tier (tier 3)”.*³

ACCC proposal was limited to provisions identified by the AER

In 2018, the AER undertook a detailed consultation with the AEMC and AEMO to determine what key provisions should attract a higher penalty. The ACCC Retail Electricity Pricing Inquiry Final Report June 2018 (REPI report) recommended a higher tier be incorporated into the revised penalty framework to align with the Australian Consumer Law (ACL), but made this recommendation only in respect of this limited set of provisions that had previously been identified by the AER:

*The ACCC considers **the provisions listed in the AER powers and civil penalties consultation paper** for increases to the \$1 million mark warrant the higher levels referenced in the ACL amendment Bill of \$10 million, 10 per cent of turnover, or three times the value of the benefit gained.*

This approach of the ACCC in referring to the earlier work of the AER seems appropriate in this context given that the REPI was focussed largely on competition issues in the electricity industry rather than issues of compliance with, and enforcement of, industry specific legislation in the electricity and gas sectors, where significant expertise and experience in this regard sits with specialist industry bodies including AER, AEMO and the AEMC.

² COAG EC SCO AER Powers and Civil Penalty Regime consultation paper, June 2018, p 13, <http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/AER%20Powers%20and%20Civil%20Penalties%20Consultation%20Paper.pdf>

³ COAG EC SCO National Energy Laws enforcement and penalty framework reforms, Explanatory note for stakeholder consultation, Nov 2019, p 5, http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/Enforcement%20Penalties%20Framework%20Reforms%20-%20Explanatory%20Note_0.pdf

As such, in assessing which provisions should be classified as tier 1, there is no basis in the REPI report or elsewhere to consider any obligations other than those initially identified by the AER.

However, as that 2018 AER assessment preceded the recommendation of even higher maximum penalties in the REPI report (ie the now proposed tier 1 level), it is appropriate to reconsider each of the provisions identified by the AER to assess how they should be classified.

The proposed Decision matrix and concept table

The consultation paper outlines the proposed principles to be considered when determining how the civil penalty provisions should be classified. These are:

- (a) the National Energy Objectives;
- (b) the key objective of civil penalty regimes, being to promote the public interest in compliance with the law; and
- (c) acknowledging there is a hierarchy of potential harm arising from contraventions of different civil penalty provisions, which is reflected in the three different maximum penalty amounts.

We consider the “acknowledging there is a hierarchy of potential harm” principle relates to the importance of identifying tier 1 obligations that could be quantitatively or qualitatively more serious than a breach of provisions attracting a lower penalty when considering the National Energy Objectives.

The current decision matrix and concept table fail to make this distinction and therefore do not achieve this principle. This is because the concept table no longer assesses or grades the seriousness of how a breach may impact the concept under assessment. Whilst for some obligations the tier 1 classification is immediately apparent given the risk to public safety, death or serious injury this is not as clear for the majority obligations assessed as a tier 1 civil penalty obligation.

The concept document sets out a list of characteristics without considering interrelationships between them. A provision is assessed as tier 1 if it meets any of the concepts in the list. For example, the current approach classifies as tier 1:

- any contravention that is ‘difficult to detect’, regardless of how serious it is; and
- not only provisions necessary to avoid large scale events such as black systems, but also any provision necessary to ensure compliance with obligations regarding service levels and standards, even if those standards are significantly less serious and may not even be noticed by consumers.

We suggest that a combination of factors may be relevant to assessing the appropriate penalty, and, at the very least, that assessing a provision as tier 1 or tier 2 should require that such maximum penalty is necessary in order to achieve an appropriate level of deterrence.

Further, although the concept document seeks to delineate between types of conduct that is classified as tier 1 or tier 2, there are many instances in which the concepts in tier 1 and tier 2 overlap. However, the 'trickle down' approach results in provisions that should properly be assessed against all three tiers being automatically included as tier 1 provisions. Taken together, these aspects of the methodology result in far too many provisions being assessed as tier 1.

We observe that the concept document in some cases defines the concepts under assessment with key terms that are not defined under the relevant energy laws or rules. For example, the term 'vulnerable customer' is not appropriately defined.

When comparing the civil penalty obligations originally recommended by the AER (AER obligations) with the draft classification tables, it is apparent that the draft decision matrix does not delineate the AER obligations under the energy laws that directly tie to the energy objectives from other sub-obligations that sit beneath these over-arching obligations.

The AER obligations include requirements that directly impact the safety and security of the NEM, key market transparency requirements, or fundamental retail obligations to customers and vulnerable customers. A breach of these key provisions may therefore seriously undermine the energy objectives. Whilst we consider the AER obligations recommendation requires further detailed consideration as to whether a breach would warrant a tier 1 classification, this list provides a much more appropriate starting point.

Rather the obligations identified in the classification table also include the prescriptive requirements in the legislation that sit underneath these over-arching obligations. These regulatory framework obligations are designed to facilitate compliance, and ultimately ensure the key obligations are met, by further prescribing technical and procedural industry requirements.

For example, the current proposal includes in Tier 1:

- clause 4.15(b) of the NER, which requires a registered participant subject to a performance standard to institute and maintain a compliance and testing program. This obligation is assessed to be of equivalent importance to the overarching obligation under clause 4.15(a) to meet the performance standard and immediately cease operation if it is likely to have a material adverse effect on power system security. Clearly clause 4.15(b) is a prescriptive obligation intended to ensure clause 4.15(a) is met.
- clause 3.8.3A(j) of the NER, which imposes technical restrictions on the ramp rates that certain generators may provide to AEMO, but which is not targeted at preventing generators from obtaining commercial gain and for which a higher penalty is unlikely to increase deterrence;
- clause 7.3.2(a) of the NER, which requires a Metering Co-ordinator to appoint a metering provider, but which is concerned with an administrative process for which a large maximum penalty is unnecessary and would not increase deterrence;
- section 282 of the NERL which requires participants to provide regular performance reports to the AER, but does not directly impact the physical operation of the market or products provided to consumers.

Including these framework obligations as Tier 1 dilute the importance of key obligations that may warrant a Tier 1 classification.

The decision matrix therefore fails to apply a meaningful hierarchy of civil penalty obligations that effectively identify the central obligations that should be elevated above other civil penalty provisions given the potential seriousness of a breach and need for a high civil penalty in order to achieve appropriate deterrence. The effect is that the industry, regulators and ultimately the court are not provided with meaningful guidance as to appropriate penalties.