ENERGY SENIOR OFFICIALS RESPONSE TO SUBMISSIONS FROM PUBLIC CONSULTATION ON CLASSIFICATION OF TIERS

Summary

The Statutes Amendment (National Energy Laws) (Penalties and Enforcement) Act 2020 (Act), was given Royal Assent on 22 October 2020 and will come into force on a date to be fixed by proclamation.

The Act will amend the National Electricity Law, National Gas Law and National Energy Retail Law (National Energy Laws) to provide for increased civil penalties through the implementation of a three tier penalty structure.

The changes in the Act will strengthen the Australian Energy Regulator's (AER) enforcement powers and the penalty regime under the National Energy Laws – particularly in the case of significant breaches, including those that impact the integrity of energy markets. The reforms will ensure that penalties for breach of the National Energy Laws are sufficient to deter contravening behaviour.

The draft Classification of Tiers, Decision Matrix and Concept Table documents related to the Act were released for public consultation in July 2020. Submissions were received from 14 entities. The level of support for the proposed classification varied between entities – in general terms, regulatory bodies, consumer representative groups and ombudsmen expressed the highest level of support while market participants were the least supportive. However the majority of the submissions received raised similar issues. These themes are addressed in the table below.

The allocated Tier is based on the most serious form of contravention that could occur – the tiered penalty amounts are maximum amounts and a minimum penalty is not proposed. A penalty may only be incurred if a corporation or individual is found, by a court, to have contravened a civil penalty provision. The maximum available penalty serves as a yardstick for the courts in the penalty assessment process, and sets the benchmark against which all contravening conduct is assessed. The AER will consider a range of factors before pursuing enforcement action and depending on the seriousness has a number of options available other than pursuing a civil penalty in the courts, including providing time to comply and offering the option of a lower infringement penalty.

Submission theme	Response
1. The Decision Matrix and Concept Table have resulted in too many provisions being allocated to Tier 1	The penalty tier sets a maximum penalty that can apply to a contravention, not a minimum. The maximum penalty serves as a yardstick in the penalty assessment process. It does not represent the penalty amount that will or is likely to be imposed by a court in any given case. There is no minimum penalty that can be imposed under any tier. A maximum penalty would only be imposed for the most egregious conduct that breaches the relevant provision. Therefore provisions have been allocated to the highest (Tier 1) level of maximum penalty where that level of penalty would be appropriate for the most serious form of contravention of that provision.
2. The Decision Matrix should allow for each Civil Penalty Provision to be assessed against all three tiers, rather than the assessment hierarchy proposed	The hierarchy structure has been implemented to minimise potential overlap between penalty provisions falling within each tier, and to ensure consistency. It provides a clear and objective decision making framework, minimising the risk that subjective judgement calls will be required to allocate penalty provisions to a particular tier. Allowing each penalty provision to be assessed against all tiers without a clear hierarchy or structure would increase complexity and uncertainty in the decision making process.
3. The proposed penalties are not proportionate to the potential harm arising from a breach or the seriousness of the contravention	The tier classification process takes account of the overall potential harm or seriousness of contraventions at a broad level. Provisions have been allocated to each tier where the maximum penalty amount would be appropriate for the most serious form of contravention of that provision. The proposed penalty regime acknowledges there is a hierarchy of potential harm arising from contraventions of different civil penalty provisions – ranging from relatively minor to severe. This is reflected in the three different maximum penalty amounts. In an individual case, the actual penalty amount imposed by a court (up to the maximum available under the applicable tier), would be based on an assessment under the penalty factors set out in the National Energy Laws and by the courts in previous civil penalty cases. These penalty factors include the need for general and specific deterrence and the nature and extent of the breach.

	As the penalty amounts set out in the Act are maximum amounts, courts have the discretion to take into account the relevant penalty factors, to determine a penalty amount that is commensurate to the breach in an individual case (i.e. for minor breaches the penalty may be far lower than the Tier 1 maximum).
4. The increases to maximum civil penalties are not justified as there is no evidence of widespread non-compliance	In agreeing to these reforms, Energy Ministers expressed the overarching aim of the reforms as being to ensure that penalties for breach of the National Energy Laws are sufficient to deter contravening behaviour. A key consideration in setting maximum penalties is to promote compliance, by ensuring maximum penalties are sufficient to deter contravening conduct. This does not require evidence of widespread non-compliance. Rather, it requires an assessment of the penalty amount required to deter theoretical non-compliance by reference to a range of factors, including the potential benefits of non-compliance. In December 2018, Energy Ministers accepted the enforcement-related recommendations of the ACCC's 2018 Retail Electricity Pricing Inquiry. The ACCC report stated "*the current civil penalty amounts are insufficient to impose a credible level of deterrence and provide meaningful consequences to businesses. Therefore, the ACCC considers that the penalties should be increased to provide the [AER] with a greater level of flexibility in its response to address breaches of the national energy laws.*". The classifications and hierarchy are in line with this recommendation.
5. Civil penalties (and specifically Tier 1 maximums) should not be applied to provisions which require compliance with instruments extraneous to the Act, such as administrative determinations, codes or procedures	Where possible the content of a civil penalty provision (including all requirements for compliance) should be clear from the face of the penalty provision itself. This is to ensure the scope and requirements for compliance are clear and able to be complied with. It is possible for civil penalty provisions to require compliance with delegated instruments where there is a need to do so, such as where compliance requires a level of detail that cannot readily be reduced to an Act or Regulations, requires frequent updating or where an entity agrees to be subject to the instrument. In setting the maximum penalties for such civil penalty provisions, regard should be had to the same key considerations as all other penalty provisions. The severity of the harm that the civil penalty provision seeks to prevent is the foremost consideration. The fact that the civil penalty provision

	requires compliance with a delegated instrument is not determinative of the appropriate maximum penalty. A guideline or determination will likely contain a range of requirements, from administrative obligations to those critical to safety or security of supply. A court will determine the appropriate civil penalty commensurate to the requirement that has been breached, and where necessary should have the highest maximum penalty available to it. These provisions include, as examples: • s 14B NEL – compliance with distribution determination. Non-compliance affects the revenue obtained by a distributor and may result in significant financial gains to the NSP and costs to consumers. • cl 6.17.1 NER – compliance with distributor ring-fencing guidelines. The guidelines impose obligations which aim to enable new entry and facilitate competition by preventing cross-subsidisation, discrimination and other market distortion. It is necessary that an appropriate penalty be available for this conduct; similar to the penalties available under the ring fencing provisions in the NGL. • cl 4.10.2(b) NER – compliance with power system operating procedures. These procedures ensure the safety and security of supply, but are by nature complex and attempting to distil them down into provisions in the NEL or NER would be counterproductive.
6. The penalty regime should not expose entities to multiple penalties for multiple contraventions arising from the same or similar behaviour.	Civil penalty regimes frequently expose entities to multiple penalties arising from the same or similar conduct, such as sending the same contravening correspondence to multiple separate consumers. In such circumstances, courts will consider whether separate contraventions have occurred, and also whether contraventions fall into a course of conduct. Courts will apply the 'course of conduct' principle in order to reach an appropriate penalty. The National Energy Laws (s 67 NEL, s 297 NERL, s 237 NGL) provide that while proceedings may be instituted for conduct in breach of more than one civil penalty provision, a person is not liable to more than one civil penalty in respect of the same conduct.
Specific comments	
7. The proposed reform results in a disproportionate application of civil	In classifying the civil penalty provisions, distributors were not deliberately targeted in allocating the tiers nor was there any policy decision taken to target distributors. However, distributors tend to have more obligations/interfaces under the framework.

penalties to distributors under the NEL and NER.	
8. It is inappropriate for the AER civil penalty regime to reflect the regime under the Australian Consumer Law due to the differences between the AER and ACCC.	The civil penalty regime is only one element of the AER's regulatory toolbox and does not impact the AER's deep technical understanding of the sector nor its relationship with participants. Parallels can be drawn between civil penalty provisions which seek to prevent harm to the market and to consumers, and maximum penalties have been recommended to apply accordingly.
9. Concerns about a move away from the recommendations of the 2013 Enforcement Review Final Report.	In December 2018, the former Energy Council agreed to implement subsequent enforcement-related recommendations of the ACCC REPI report including recommendation 42, which proposed maximum penalties under the national energy laws should align with those of the Australian Consumer Law.
10. Concerns about a move away from the stated policy position in the 2019 Explanatory Note for the Draft Legislation, that 'With some exceptions existing civil penalty provisions will be subject to the bottom tier (tier 3)'.	Taken in a broader context, the policy position outlined in the 2019 Explanatory Note is that all existing penalty provisions other than the rebidding provisions and the RRO provisions, will be subject to the new tier 3 penalty rates, until a separate process can be undertaken to reclassify provisions under the three tier system. Page 4 of the 2019 Explanatory Note states: 'Once the Bill becomes law, the Energy Council may decide to specify a particular requirement of the national energy laws to be subject to one of the three available penalty tiers. This decision will be given effect through the making of regulations and will be the subject of a separate process'. Page 7 also states: 'The Energy Council will be separately consulting on which, if any, of the existing provisions in the law shall be subject to the higher tier penalty rates.'
11. Penalties for failing to meet information obligations are generally too high e.g. there a number of comments that these are administrative and/or the impact of a breach would be small.	Obligations that require the provision of information to the AER or AEMO assist the oversight of the market by regulators. For example, notification of associate contracts in the NGR is the main source by which the AER can monitor compliance with the ring-fencing provisions of the NGL. The requirement to publish certain information can in some instances have effects on entry into or access to the market – such as the requirement of a retailer to publish a standing offer or the

	requirement for a transportation service provider to publish the identity of a facility operator under the NGR.
12. The over-reliance on Tier 1 and Tier 2 classification could have perverse outcomes in terms of discouraging self-reporting of non-compliance.	Self-reporting and other co-operation with the AER would be a factor that the AER would consider in determining the appropriate compliance or enforcement outcome, and would also be considered by a court in determining the appropriate civil penalty. Conversely, a failure to report or co-operate with the AER would be viewed negatively by a court in determining the civil penalty
13. There is a misalignment with current AER policies/guidelines e.g. Application of Tier 1 and Tier 2 does not align with the reportable breaches in the AER NERL compliance guideline.	Immediate reporting is required for many Tier 1 proposed provisions such as life support obligations and disconnection of small customers in certain circumstances including where the hardship or residential customer is adhering to a payment plan. Explicit informed consent requires quarterly reporting but this does not detract from its fundamental nature as a consumer protection provision. Failure to obtain explicit informed consent can prevent consumers from accessing their preferred energy supply arrangement or result in the uninformed accumulation of debt.
14. The proposed arrangements will push up compliance costs. 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.	The higher penalty amounts will not be incurred if the relevant parties comply with the National Energy Laws. Compliance with the National Energy Laws, including all civil penalty provisions should be part of a business's normal operating activities.
15. Infringement notices will become disproportionate - The increase in maximum civil penalties means the penalty amount for infringement notices increases comparably. This is problematic because infringement notices do not receive the same level of discretion as a court judgment.	The infringement notice penalties have been increased to a level that is reflective of the potential harm caused by alleged breaches. The AER can issue infringement notices if it is satisfied that it has reason to believe that a civil penalty provision has been breached. In order to determine the number of notices to issue, the AER has regard to a range of matters including the penalty factors set out in the National Energy Laws and in a number of court cases. By considering these matters, the AER ensures that the number of infringement notices issued is proportionate to the overall conduct.

16. The significant increase in the infringement penalty levels could incentivise parties to take their chances before the courts.	It is open to a person issued with an infringement notice to elect not to pay the infringement notice penalty. A court may order significantly higher penalties (along with costs orders and other remedies) if it finds that a civil penalty provision has been breached. The amount of the relevant infringement notice penalty will not be a factor in the court's consideration of the appropriate civil penalty.
17. There is a disconnect in that a lower level infringement penalty can be applied to Tier 1 and Tier 2 breaches. Note that Commonwealth guidelines suggest infringement penalties are for less serious breaches.	Infringement notices are issued at the discretion of the AER. The higher infringement notice penalties for all civil penalty provisions, including those in Tier 1 and 2, are not inconsistent with the principle around issuing infringement notices for less serious, or technical breaches. Infringement notice penalties are now set at a level that is more likely to provide deterrence given the size of the regulated businesses.
18. Under the proposed regime, workers [i.e. individuals] will now face a maximum penalty of $500,000 for Tier 1 offences. The public interest benefit in imposing such severe penalties does not outweigh the negative impact it will have on the wellbeing of workers. The maximum penalty is well beyond the average annual salary of a worker and, even after court discretion, is likely to be a disproportionately harsh response.	A court would, in the exercising of its discretion to impose a civil penalty upon an individual, consider factors including the degree of culpability, level of seniority, intent, severity of the breach, and an individual's ability to pay the penalty.
19. The way the NEO is used in the concept table - as if the various aspects of consumer interest operate as discrete and separate objectives of the NEL and NER - is contrary to the proper interpretation of the NEO as an overall economic efficiency objective as confirmed by the Courts.	Promoting compliance with the regulatory framework is entirely consistent with the "overall economic efficiency" objective. The concepts table draws on and develops the various components of the energy objectives to build an objective framework that can be used to determine the appropriate tier for each civil penalty provision in the National Energy Laws.

	Even though one civil penalty provision is more appropriately regarded as being relevant to a particular component of the energy objectives, that does not mean that the energy objectives are being undermined or improperly applied. For example, a failure to follow dispatch instructions has been assessed as having system security and adverse market impacts. However, this conduct would also result in consumer harm because consumers will ultimately have to pay for system security upgrades and inefficient prices due to distorted market behaviour and investment signals. Overall, the failure to follow dispatch instructions results in significant inefficiencies in electricity markets.