AUSTRALIAN ENERGY REGULATOR

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Dear SCER Secretariat

Submission on the Review of Enforcement Regimes under the National Energy Laws Draft Report

The Australian Energy Regulator (**AER**) welcomes this opportunity to comment on the Allens/NERA Draft Report for the Review of Enforcement Regimes under the National Energy Laws. Overall, we consider that the proposed amendments to the enforcement regime are in the long term interests of consumers and will help to ensure that the integrity of the energy market is maintained.

The recommendations contained in this Review provide the AER with a more comprehensive and robust set of enforcement powers to support our role. There are, however, some areas which require further consideration and we address these in more detail in the attachment to this letter.

We would be pleased to provide further assistance on this important area of work. If you would like to discuss any aspect of this submission, please contact Tom Leuner, General Manager, Wholesale Markets, on (03) 9290 1890.

Yours sincerely

Andrew Reeves
Chairman
Australian Energy Regulator

Introduction

The AER's decision making is guided by the objectives set out in national energy legislation. These aim to promote efficient investment in, and efficient operation and use of, energy services for the long term interests of energy consumers with respect to price, quality, safety, reliability and security of supply. A robust enforcement regime that has a range of enforcement options available to the regulator is important for the achievement of this statutory objective. It delivers credible deterrence to non-compliance and meaningful consequences for businesses that adversely affect consumers or create risks to the efficient and reliable operation of the market through non-compliance.

We only take statutory enforcement action when necessary, consistent with our public statements of approach to compliance and enforcement.[1] Since our establishment in 2005, we have served 10 infringement notices over five occasions (i.e. multiple notices on some occasions) in relation to alleged breaches in wholesale energy markets and two in retail markets since the commencement of the National Energy Retail Law (**Retail Law**) in 2012. We have instituted court proceedings on only one occasion. The vast majority of compliance issues are addressed through administrative resolution; that is, by seeking voluntary commitments from businesses to remedy compliance issues.

We support the principle that there should be consistency in enforcement regimes across the National Electricity Law (**Electricity Law**), the National Gas Law (**Gas Law**) and the new Retail Law. This provides predictability and certainty, allowing the regulated community to know where it stands. It also allows consistency in our approach, which has positive implications for our resourcing.

We support the majority of the Draft Report's recommendations as they propose a wider range of enforcement options for the AER and participants, and a wider range of orders for the courts. Comments on particular recommendations are provided below.

Issue 2*: Are the AER's statutory rights to undertake enforcement action appropriate and sufficient for its purposes as the national regulator under the National Energy Laws?*

The Draft Report discussed providing an additional enforcement power, short of court proceedings, in relation to provisions that are not civil penalty provisions. This would allow the AER to issue a regulated entity with a direction to comply and failure by the entity to do so would constitute a civil penalty provision. This option is not recommended in the Draft Report as it was considered that the additional enforcement powers conferred on the AER might be disproportionate to the perceived gap in the effectiveness of the current enforcement regime.

Contrary to the conclusion of the Draft Report, the AER considers that the ability to issue such compliance orders would complement our current approach to enforcement and proportionately extend the available enforceable options for provisions that are not subject to civil penalties. We consider the current gap in the enforcement regime for these provisions to be significant, as the only formal option available to us is to seek court orders. As stated in the Draft Report, it is unlikely that the commitment of financial and other resources needed for court proceedings will be warranted for these types of provisions. Seeking a court order can be a time-consuming process and in many cases, the nature of the contravened provision may be such that court orders are an ineffective or disproportionate remedy.

While administrative compliance work by the AER has been effective on many occasions, sometimes even after significant effort and repeated administrative commitments, significant breaches continue to occur. The work the AER does in addressing matters through administrative resolution is only sustainable if we also have the *option* of taking proportionate formal enforcement action. We consider that cases of repeated non-compliance for non-civil penalty provisions sometimes occur because regulated entities do not regard court action as a credible option for the regulator.

Many provisions that are not classified as civil penalties would benefit from the compliance order option. For example, the requirement on electricity network businesses to carry out a Regulatory Investment Test to identify the network investment option which maximises net economic benefits.

[1] For wholesale markets, see Compliance and Enforcement Statement of Approach, December 2010; for retail markets, see Statement of approach: compliance with the National Energy Retail Law, Retail Rules and Retail Regulations, July 2011.

The AER has requested network businesses to repeat the test where we have identified shortcomings in their original application of it. While businesses have stated they will meet these requests, the AER has no further options, short of seeking a court order, that it can take if the business did not follow the AER's request. If allowed to issue a compliance order, the AER could issue a direction requiring the business to repeat the test without employing the resources required to go to court.

As this example highlights, a compliance order would provide an effective lower level enforcement tool, which would act as a deterrent to the business concerned and others in the sector. Similar arguments could be applied to our dealings with compliance issues for the provision of metering data, annual network planning requirements, requirements for gas market allocation data and retail complaints handling.

It is unlikely that the AER would use compliance orders as a first response, but rather as a follow-up step where initial (voluntary) administrative actions prove unsuccessful. We consider that having the ability to make these orders will strengthen the effectiveness of developing initial administrative solutions and reduce the occurrence of repeated breaches of provisions not classified as civil penalties. Consistent with all formal enforcement actions, compliance orders would only be issued upon approval of the AER Board. Moreover, if the AER were to issue an infringement notice for breaching a compliance order, the recipient has the option of not paying and forcing the AER to take the matter to court. It is this latter option available to recipients which acts as an important check on the AER's enforcement decisions, helping to avoid the disproportionate use of this new power.

Issue 7: *Does the conduct provisions regime continue to have a useful function in relation to 'enforcement' proceedings between industry participants? If so, what modifications should be made to make it more effective?*

The current conduct provisions regime in National Energy Laws allows for the private enforcement of regulatory obligations. This allows a person other than the AER to seek a court order declaring that another person is in breach of a designated provision. In general, conduct provisions apply to the conduct of one industry participant that will directly affect another industry participant.

The AER agrees with the principles outlined in Recommendation 3 that should be applied in deciding whether new provisions should be designated as conduct provisions. This will ensure consistency in approaches across the electricity, gas and retail legislation and rules.

We also agree with the recommendation that provisions relating to preventing or hindering access and the connections framework under the Electricity Law and Rules should be reclassified as conduct provisions. We consider that a number of the 'business-to-business' retail obligations would be appropriate conduct provisions to reflect the interdependence of these businesses in achieving compliance. Examples include provisions relating to information sharing on life support registers, and arranging disconnections/reconnections requested by retailers in accordance with service standards.

***Issue 14**: Are the existing civil penalty rates set at a level which is sufficient to act as a deterrent? How should the quantum of a civil penalty be determined in line with current norms?*

The Draft Report recommends that the maximum civil penalty level of $1 million for bodies corporate should be extended to cover other provisions in the Energy Laws and Rules (the higher penalty currently applies only to the wholesale electricity good faith rebidding provision). We support this view and agree that it will provide an effective deterrent for non-compliance and better reflect the seriousness of certain offences.

The Draft Report invited submissions on which provisions should be subject to this higher penalty. The AER considers the higher penalty is appropriate for provisions where non-compliance could result in potentially significant financial gains for a regulated entity, or for those provisions where a breach could have significant consequences on energy supply security or consumers. These provisions span across all Energy Laws and Rules and could include the following non-exhaustive list:

- the requirement to follow dispatch instructions under clause 4.9.8(a) of the Electricity Rules
- the requirement to provide good faith best estimate gas offers (Gas Rules clause 213(2)), and

- provisions relating to disconnection of life support customers (Retail Rules clauses 124(1) and 125(2)).

Furthermore, we note that under current civil penalty levels, businesses may not have an incentive to dedicate adequate resources to achieving compliance in certain areas. It is not always the case that the business is directly intending to breach, however by not prioritising staff, systems and processes to meet their obligations, there may be an increased risk of a breach occurring. Extending the higher penalty to cover more provisions would mean the cost of non-compliance will likely outweigh the benefits to the business of not spending sufficient money/staff time on systems and processes that support higher levels of compliance. In other words, the high potential penalty signals to businesses the importance of investment in activities that will achieve higher levels of compliance. We therefore consider that obligations which directly or indirectly require the maintenance of systems and processes should also be included in the group that would be subject to the $1 million penalty.

The Draft Report also recommends that the maximum penalty for the rebidding civil penalty provision be amended to be the greater of $1 million (the current maximum) and a multiple of three times the total value of benefits derived from the non-compliance. We agree with this recommendation. It would be a particularly effective deterrent for provisions where significant financial gains can be made from non-compliance. With the option of calculating the penalty based on the financial gains, there will be an incentive to comply because if the court finds a breach the penalty will exceed the gain.

We therefore suggest that this recommendation should be extended to any other provisions which are amended under this Review to have the $1 million maximum civil penalty and have financial benefits of non-compliance (for example, the requirement to follow dispatch instructions).

We recognise that there may be some difficulties associated with calculating the gains derived from contravention, however, we consider that a precedent has been set for such calculations under other enforcement regimes where similar penalty methods have been used successfully (such as in the U.S. energy sphere and in the context of cartel matters). Furthermore, the $1 million penalty is always an alternative option if the gains are difficult to calculate.

Issue 23*: Should the AER have the power to compel the provision of oral evidence under oath?*

Finally, we agree with the Draft Report's recommendation that the National Energy Laws should be amended to allow the AER to compel the provision of evidence under oath. This additional power would only be used rarely, and would not alter our approach of having less formal discussions with companies and seeking administrative solutions where this would achieve the most appropriate outcome.

We agree with the Report's conclusions that the ability to compel evidence under oath would enable the AER to more effectively fulfil its investigative and enforcement function by:

- providing the AER with a greater ability to investigate contraventions which include a mental element and test the accuracy of documented evidence, and
- allowing the AER to make a more informed and accurate assessment of whether a breach has occurred and better guide effective enforcement decisions.