



**Energy Security Board  
Compliance and Penalties Technical Working Group**

## **Penalties – Emissions Reduction and Reliability requirements**

### **Issues Paper**

#### **Introduction**

The purpose of this paper is to facilitate discussions with Jurisdictions and the Technical Working Group (TWG) on an appropriate penalty framework in the event of non-compliance of the emission or reliability obligations. Following the Senior Committee of Officials (SCO) Reference Group and TWG meetings, a more detailed technical working paper will be developed. The technical working papers and draft final design document will be available for public consultation in mid-June.

#### **High level design**

The Australian Energy Regulator (AER) will be the enforcement agency for both the emissions reduction and the reliability requirements of the Guarantee, however a detailed design for both of these areas is yet to be settled. The penalty framework will therefore evolve as the design is settled. Decisions on other design elements will take into account the ability to monitor compliance and the penalty regime for non-compliance.

The AER has access to a range of compliance tools when deciding whether to take enforcement action and the nature of that action. In determining an appropriate enforcement response, the AER considers all relevant factors and circumstances.

Potential enforcement tools, based in most cases on the AER's current powers, are listed below and in section 3.5.3 of the high-level design paper.

With regard to the reliability obligation, if a liable entity does not have adequate enduring contracts in place to meet their share of system peak demand and the requisite conditions for non-compliance are met, then the AER should have the powers to issue a penalty (and assess cost of procuring an enhanced Reliability and Emergency Reserve Trader (RERT)) on non-compliant retailers..

With regard to the emissions reduction requirement, if, despite any flexible compliance options, a retailer fails to meet the emissions reduction requirement, the AER must have appropriate powers and enforcement tools to ensure the policy objectives are met, and therefore the non-compliance is addressed in a timely and effective manner.

#### **Detailed design elements for TWG input**

##### **1. Reliability requirement**

The reliability requirement does not lend itself to an explicit graduated compliance framework. Therefore, non-compliance needs to be discouraged through a financial penalty.

The compliance framework must create a strong incentive for compliance. The Energy Security Board ESB has indicated that penalties should be linked to ex post observed costs. It is expected that at least some of the cost of the RERT will be imposed as penalties.

Once the reliability obligation is triggered, compliance with the reliability obligation will only be assessed when two conditions are met: the Australian Energy Market Operator (AEMO) had to exercise its procurer of last resort function and actual system peak demand exceeds that which would be expected to occur one in every two years. This raises the question of whether applying a portion of the cost of the RERT, as a penalty for non-compliance is a sufficient deterrent.

- On one hand, retailers may consider the risk of the above two conditions are manageable as it is not certain to eventuate.

- On the other hand, should the event occur, retailers will not know the RERT costs other than that they are likely to be significant. Retailers are experts at managing the financial risk that arises from buying energy from the spot market and selling to customers at a firm price. They are therefore better placed to purchase financial products that drive investment than AEMO as the procurer of last resort. Retailers are therefore likely to find a cheaper solution than AEMO. This is a strong motivator for retailers to avoid the trigger occurring at all.

It will be important to make sure that in any penalty regime, the AER has sufficient discretion to administer the penalties. A two-stage approach to compliance could be undertaken:

- In the first stage, the AER's assessment would evaluate whether market customers contracted to a level consistent with their share of system load during the forecast gap period. This assessment would identify the extent to which retailers have fallen short of the reliability requirement for the purposes of allocating the RERT costs on a relatively formulaic basis.
- In the second stage, the AER would retain its ability to apply its usual suite of enforcement options. These enforcement options would likely only be used for more significant or repeated failures to comply with the reliability obligation.

Questions for the TWG:

- Should the penalty/cost allocation cover the entire RERT cost or just a portion?
- How should the share of RERT costs be calculated for each non-compliant retailer?
- How should the penalty/cost allocation be recovered? This includes the mechanism for recovery, eg through the AEMO settlements systems, and whether the recovery is over time or all at once.
- What additional civil penalties should apply, over and above an allocation of the RERT costs?

## 2. Emissions reduction requirement

This component of the mechanism will include obligations such as providing information and the format and accuracy of this information. Given the emissions reduction obligation will be a recurring obligation, the AER's enforcement approach will build on its existing compliance and enforcement processes.

The AER would annually publish high-level compliance outcomes, such as the proportion of entities covered by the Guarantee that complied with the emissions reduction requirements. At this stage, the detailed design regarding the flexibility arrangements (e.g. ability to carry forward over/under achievement) are yet to be settled. If, however, after taking into account these flexibility arrangements, retailers fail to meet the emissions reduction requirement, the AER needs to be able to enforce compliance.

The AER already has access to a range of compliance tools and discretion in deciding whether to take enforcement action and the nature of that action. Each case is assessed on its merits. In determining an appropriate enforcement response, the AER considers all relevant factors and circumstances.

Potential enforcement tools, based in most cases on the AER's current powers, are outlined below (noting that these could apply in addition to the automatic carry-over of a retailer's under-compliance with the emissions reduction requirement in one compliance year to the next compliance year).

- Culture of compliance: Minimising non-compliance through informing, educating and engaging stakeholders is better than enforcement action after a breach has occurred. The AER should actively educate and engage with the market to ensure participants understand their obligations and encourage compliance.
- Administrative undertakings: Administrative resolutions are a more informal and less intrusive enforcement option which the AER uses to resolve certain matters. The AER

may be more likely to accept an administrative undertaking where the effect of an actual or potential breach is limited, and a business has taken (or agreed to take) appropriate steps to end the conduct and to remedy any harm done.

- Infringement notices: These specify the nature of the contravention and the amount of the penalty that must be paid. The AER's current practice is to publish all infringement notices. The amount of the penalty must be sufficient to act as a deterrent.
- Enforceable undertakings: These are written statements from an entity that it will take specified actions (for example, entering into contracts in order to resolve a breach). Compliance with these undertakings can be enforced by the courts and are a valuable tool in addition or as an alternative to infringement notices..
- Institute civil proceeding: The AER can initiate civil proceedings in the courts for alleged breaches of civil penalty provisions of the national energy laws:
  - Injunctions: A court may order an injunction requiring a person to do something or desist from doing something.
  - Civil penalties: A court may order that an entity pay a financial penalty as a result of breaching its obligations. The definition of "civil penalty" in the NEL may need to be amended in order to provide for more meaningful upper limits on civil penalty amounts (as has been done in respect of rebidding civil penalty provisions).
- Suspending market participation or revoking retail authorisation: As a final step, in cases of significant and repeated non-compliance, the AER may take steps to remove the liable entities ability to participate in the National Electricity Market

The primary approach at the outset should be to build a culture of compliance. Given that the Guarantee will be new to market participants, the AER will need to ensure that the appropriate information is easily available to retailers and that they understand the requirements and mechanism through which they can meet their requirements.

If however, compliance and enforcement action is required to address non-compliance, the AER must have appropriate powers and enforcement tools to ensure the policy objectives are met, and therefore the non-compliance is addressed in a timely and effective manner.

As the flexibility design elements are settled further consideration will be provided as to what enforcement regime is required for each of the aspects of this obligation, beyond relying on a culture of compliance.

Questions for the TWG:

- What aspects of the obligations warrant a civil penalty? For example, in the event of a failure to provide information.
- Do you consider the current civil penalty upper limits on civil penalty amounts are appropriate for these obligations?

## Interdependencies with other elements of the Guarantee

The detailed design for both the emissions reduction and the reliability components of the Guarantee is yet to be settled. The penalties framework will therefore evolve as the design is settled. Decisions on other design elements will take into account the ability to monitor compliance and the penalty and cost allocation regimes for non-compliance. The TWG are encouraged to provide any other comments as the detailed design is further developed.