

MEMORANDUM OF ADVICE
ENFORCEMENT PROVISIONS IN THE
1 DECEMBER 2004 EXPOSURE DRAFT FOR A BILL TO AMEND THE NATIONAL ELECTRICITY LAW

In many respects the substantive provisions of the Exposure Draft to amend the National Electricity Law contribute to the desirable goal of a more integrated national energy market which will better serve the long term interests of end consumers of electricity.

However, the enforcement regime¹ would work to the significant long term disadvantage of electricity consumers as industry passes on the costs of compliance and an excessive regulatory burden.

The enforcement provisions are already significantly more draconian than any equivalent Commonwealth regime (ACCC², ASIC³ and APRA⁴) or comparable overseas energy enforcement regime (FERC (US) and Ofgem (UK)). In certain respects the powers would be significantly extended.

For example, by not carrying across to the Exposure Draft the distinction in the existing Law between penalty classes A, B and C⁵ the maximum penalty for contravening many provisions of the Law will be increased from maximum penalties ranging from \$5,000 to \$50,000 to a new maximum of \$100,000⁶, up to a 20 fold increase. In several other respects (exposing staff to penalties, injunctions and orders for disconnection) the Exposure Draft also duplicates or extends existing court powers.

The Exposure Draft would confer upon a Commonwealth agency enforcement powers that not only exceed those of other comparable Commonwealth agencies but are manifestly disproportionate to the contraventions in respect of which they operate.

For example, the AER would have the power to apply for a warrant⁷ to enter, search and seize documents, in circumstances where the alleged breach of the National Electricity Rules covers the full range of provisions, including matters as minor as the requirement to install meters that

¹ Part 3, Division 2 and Part 6 of the Exposure Draft

² *Trade Practices Act*

³ *Corporations Act*

⁴ *Banking Act, Insurance Act, Life Insurance Act*

⁵ Section 13 of the current National Electricity Law

⁶ Section 57 of the Exposure Draft – see definition of “civil penalty”

⁷ Division 2, Part 3 of the Exposure Draft

meet the requirements of the Rules⁸. While such a power may well be appropriate for some breaches of the National Electricity Rules the consequences of which are significant from a public welfare perspective, it is hard to comprehend why breaches of a large number of relatively trivial and procedural rules within the National Electricity Rules should attract the power to issue a warrant.

The AER would also gain the ability to issue infringement notices⁹ setting out penalties (for any contravention other than the contravention of a rebidding provision) of up to \$20,000 to be paid by participants to avoid court action.

In our experience it is unprecedented for a Commonwealth agency to be established with extreme enforcement powers without an extensive public debate¹⁰. For example, by contrast, the special powers given to the ACCC under the specific regulatory regime for the telecommunications sector are extended enforcement powers applying to existing competition law concepts introduced following detailed independent inquiry and industry participant consultation. Under the telecommunications specific regulatory regime, the extended powers of the ACCC to issue Competition Notices are constrained by statutory guidelines, and the ACCC does not specify a pecuniary payment for the alleged breach.

To address these concerns, the Exposure Draft should be amended in the following key ways:

- the National Electricity Law should provide for graduated penalties proportionate to the seriousness of the contraventions as do comparable regulatory regimes (*Corporations Act* and energy market laws in other jurisdictions);
- the power of a court to order disconnection of a generator or network thereby effectively bringing about the demise of an electricity business should be removed from the Bill, or at least limited to circumstances in which a contravention puts personal or system safety significantly at risk;
- individuals who are not involved in contraventions should not be exposed to personal liabilities; and
- consistent with all other comparable regulatory regimes, the powers to issue and exercise warrants should be removed (or at a very minimum be last resort powers which can only be used in defined circumstances).

⁸ Clause 7.2.5 of the National Electricity Rules

⁹ Division 5, Part 6 of the Exposure Draft

¹⁰ For example see in relation to the telecommunications enforcement regime: Productivity Commission, *Report on Telecommunications Competition Regulation*, (PC2001d) Report No. 16.

1. Putting National Electricity Law enforcement in context

The National Electricity Law is only one of the regulatory regimes which apply to the electricity industry. The enforcement provisions of the National Electricity Law should be appropriate for the regulatory function that it performs and proportionate having regard to the functions of other regulatory regimes including the *Corporations Act* and the *Trade Practices Act*.

The following table summarises the roles of the National Electricity Law and each other significant regulatory structure applying to the electricity sector.

Policy issue	Regulatory regime
Insider trading and market manipulation	<i>Corporations Act</i> (Chapter 7)
Site, equipment and occupational health and safety	Specific state legislation
Physical system coordination – access and connection standards, generator dispatch, system stability	National Electricity Law
Market exchange coordination – generator dispatch, matching of supply and demand and wholesale market settlements	National Electricity Law
Environmental standards	Specific state legislation

The functions that the National Electricity Rules fulfil are to provide for ubiquitous interstate:

- physical system coordination; and
- market exchange coordination.

The enforcement regime should be tailored and proportional to those matters.

In particular, it should be noted that the National Electricity Law is not the regime under which:

- anticompetitive conduct is prohibited – that regulatory framework is provided by Part IV of the *Trade Practices Act*; and
- insider trading and market manipulation of the derivative products is prohibited – that regulatory framework is provided by Chapter 7 of the *Corporations Act*.

2. Sanctions for Law and Rule breaches

2.1 Penalties

The existing penalty structure is a highly graduated one in which the exposure of businesses is limited depending on the nature and severity of the contravention. For example, the maximum penalty for installing a meter that does not meet the accuracy requirements of the Rules is \$10,000¹¹ while doctoring data stored in a meter attracts a maximum fine of \$100,000¹².

That graduated structure is achieved by a broad classification of provisions into Class A (maximum penalties of \$5,000 to \$20,000 depending on the provision), Class B (penalties of \$50,000), Class C (maximum penalty of \$100,000) and Class D (maximum penalty of \$1m). *See Appendix 3 for further details of the categories of code breaches.*

The new penalty regime has just two categories, \$1m for the rebidding provisions and \$100,000 for all other provisions. As a result the maximum penalty for many provisions has increased fivefold, and in some cases the increases have been even greater.

For example, the maximum penalty for installing a meter that does not meet the accuracy requirements of the Rules would increase from \$5,000 to \$100,000.

A graduated penalty structure would be consistent with the penalty structures in other regulatory regimes where contraventions range considerably in severity. For example, the *Corporations Act's* penalties range from a maximum of \$550 for failing to lodge notice of a resolution of name change within 14 days or failing to provide ASIC with updated information in relation to the company's share register to a maximum of \$220,000 for individuals (and \$1.1 million for corporations) convicted of offences such as insider trading, breaches of directors' duties and insolvent trading. The structure provides the business community with an accurate signal as to the severity and consequently the optimal compliance effort that applies to each prohibition. The structure as a whole is transparent, predictable and provides business certainty.

2.2 Significantly expanded scope for infringement notices

Throughout the Australian legal system, law enforcement agencies are allowed to issue "on-the-spot" fines without reference to the courts only where breaches can be easily and objectively detected and where the severity of the contravention is relatively minor. That is also the case in the current National Electricity Law pursuant to which NECA can impose a fine of up to \$20,000 for Class A (that is, minor) breaches.

¹¹ Clause 7.2.5

¹² Clause 7.8.4

The Exposure Draft would extend these powers to the full extent of the National Electricity Law's vast spectrum of trivial to serious contraventions¹³.

For example, very serious and subjectively determined contraventions such as failing to install alarm systems that are "adequate" to protect the transmission system when connecting a generator would become subject to infringement notices issued "on the spot" directly by the AER without first making a case out in court¹⁴.

Even in the telecommunications specific regulatory structure (which provides a specific enforcement regime in relation to the competition rules applicable to that industry) the power conferred on the ACCC to issue Competition Notices is constrained. Competition Notices themselves do not impose penalties but operate as a warning and as rebuttable prima facie evidence of the matters set out in them. Further, the ACCC is required under the *Trade Practices Act* to put in place and adhere to guidelines in respect of the Competition Notice provisions¹⁵.

2.3 Disconnection

Section 61 of the Exposure Draft would provide that generators, transmission systems, distribution systems and loads can each be disconnected in accordance with the Rules and a party suspended from purchasing or supplying electricity through the wholesale exchange.

The existing provision in the National Electricity Law concerns the disconnection only of a specific customer load.¹⁶ The Exposure Draft would newly apply the power to impose disconnection to a whole generator and/or network and the power is not confined to breaches of the Law or the Rules that put safety at risk but could potentially be applied for any breach.

In the electricity industry, such an order would have the effect of discontinuing or putting to an end a participant's whole business. That amounts to a significant sovereign risk that would discourage parties from participating in the electricity industry altogether.

Such an order is considerably more draconian than under comparable regulatory regimes. The orders that a court can impose for *Trade Practices Act* breaches are limited to penalties, damages and injunctions – but not an order that a business cease operating. Even in the US, the remedies for anti-trust violations extend to criminal sanctions and divestiture of a business, but not an order to bring about the demise of a business.

¹³ section 73 of the Exposure Draft

¹⁴ clause 4.11.1(c)

¹⁵ Sub-sections 151AP(1) and (2)

¹⁶ sub-section 44(2)(f) of the National Electricity Law

At the very least, a disconnection order should only be available when the contravention at issue puts safety significantly at risk.

2.4 Injunctions and duplicative orders

The Exposure Draft currently empowers a Court to issue:

- both:
 - injunctions restraining the relevant participant from engaging in conduct (sub-section 60(3)(a)); and
 - orders that the relevant participant cease within a specified period the act, activity or practice constituting the breach (sub-section 60(2)(b)); and
- both:
 - injunctions requiring the relevant participant to do something (sub-section 60(3)(b)); and
 - orders that the relevant participant take such action or adopt such practice as the Court requires (sub-section 60(2)(c)).

In each case above, the pairs of orders are duplicative and there is a significant risk that a Court interpreting the provisions would construe the sub-section 60(2) orders to extend to cover situations to which injunctions are not amenable. That additional, ill defined risk of enforcement exposure contributes to a heavy handed and unpredictable enforcement regime that would discourage creativity and innovation in the industry or even at the margins discourage participation in the electricity industry altogether to the long term detriment of electricity consumers.

3. Exposure of employees and managers

Employees and managers under the *Trade Practices Act* and the *Corporations Act* are exposed to personal penalties in respect of acts by a corporation if they are:

“...in any way directly or indirectly knowingly concerned in, or party to, a breach of a civil penalty provision.”¹⁷

¹⁷ In the *Trade Practices Act*, for example, the provision is sub-section 76(1)(e)

The Exposure Draft adopts that standard in section 66(1)(b).

However, in a significant over-reach of exposure, sub-section 84(1) of the Exposure Draft which is transposed from section 80 of the existing National Electricity Law, additionally provides that:

“If a corporation contravenes an offence provision or is in breach of a civil penalty provision, each officer of the corporation is to be taken to have contravened the offence provision or to have been in breach of the civil penalty provision if the officer knowingly authorised or permitted the contravention or breach.”

An “officer” includes both directors and any “person who is otherwise concerned in its management”. That class of employees of a corporation is very much broader than other recognised classes of manager. For example, an “officer” under the Corporations Act is “a person who makes or participates in making, decisions that affect the whole, or a substantial part, of the business of the entity or who has the capacity to affect significantly the entity’s financial standing” – that is, a very senior manager.

That provision is a significant over-reach because:

- there is a presumption of the guilt of a whole class of executive and non-executive, senior and junior managers of the corporation;
- this provision will only be of substantive effect in areas where section 66 does not apply – that is where a person was *not involved* in a breach but “authorised” or “permitted” the breach; and
- the terms “authorised” and “permitted” are not defined. They may apply in diverse contexts from general authorisations such as the delegation by a company’s board to its CEO to do all things necessary or convenient to operate an electricity business to a trading room manager delegating to a generation plant manager the authority to place bids and operate a generator during the night shift.

The quantum of penalties for individuals is also excessive by comparison to other contexts. Under the *Trade Practices Act* the maximum penalty for an individual in respect of a civil contravention is one twentieth of the maximum penalty for a corporation or one half the size of the maximum penalty proposed in the Exposure Draft in respect of rebidding rules. Under the *Corporations Act*, individuals face penalties one fifth of those applying to corporations found to have engaged in the same contravention. In both cases the maximum penalty falls well short of the Exposure Draft’s proposed new \$1m fine for contravening the rebidding rules.

It would be difficult for any prudent manager to adequately protect themselves from exposure under this provision. The possible consequences of that include that:

- the most competent managers will be attracted to industries other than the electricity industry;
- managers will seek a higher salary due to the risk of exposure to penalties;
- all managers will extensively duplicate each other's management checks to ensure each one is not exposed;
- managers will be reluctant to authorise or permit actions and thereby the electricity system will become inflexible and slow to react to changes in supply and demand.

Each of those outcomes would be of significant detriment to the long term interests of end consumers of electricity.

4. Warrants

The Exposure Draft would transfer NECA's warrant powers to the AER. In a context in which the powers have not been used and are excessive when compared with the powers of equivalent Commonwealth and overseas regulators, it would be appropriate to dispense with them.

In the United States, the equivalent of the AER, the Federal Energy Regulatory Commission (**FERC**) can:

“...administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, contracts, agreements or other records relevant or material”.

However, FERC does not have the power (either on its own motion or by warrant) to force entry to premises, search or seize materials.

The United Kingdom's Office of Gas and Electricity Markets (**Ofgem**) has the power to obtain information from licensees and others in relation to potential breaches of electricity and gas licenses, under section 28 of the *Electricity Act 1989*. A person who refuses to comply with a notice requiring information to be furnished to the Authority is liable on conviction to face a fine and a court order to provide the information.

In addition to the enforcement of the market rules, Ofgem also has competition law powers. In that context it can seek from a court a warrant to enter premises forcibly but only if:

- an investigator has already unsuccessfully ordered the production of documents, or unsuccessfully exercised the power to search premises; or
- there is a concern that documents would be concealed, removed, tampered with or destroyed.

Note, however, that those limited and last resort warrant powers are available in respect of competition law matters equivalent to Part IV of the Australian *Trade Practices Act*, not the enforcement of market rules.

The Australian Securities and Investments Commission's (**ASIC**) powers to obtain warrants for the Federal Police to seize materials in respect of enforcing the *Corporations Act* are set out in sections 35 and 36 of the *ASIC Act*. It provides that warrants are only available from magistrates where ASIC has exercised its powers to require the production of materials and persons required to produce the materials have failed to do so. Further, the extent and prerequisites upon ASIC's powers to require production vary depending upon the nature of the contravention in question.

The Bill to amend the *Trade Practices Act* following the Dawson Committee's report provides warrant powers to the ACCC but makes it clear that warrants are powers of last resort by setting out a voluntary search procedure.

Otherwise, the principles to apply in the Exposure Draft and the Dawson Bill are similar but differently expressed. Anomalies between the two regimes' provisions create the following problems:

- It can be confusing and difficult for the officers seeking and exercising the powers to remember the differences.
- The guidance provided by the case law on one regulatory regime is not necessarily good guidance on the other regime.
- Courts can take the view that the legislatures intend different standards to apply when different language is used.

While warrant powers may be appropriate for the enforcement of competition law or insider trading laws, international precedent and the history of the Australian electricity industry indicate that they are not necessary or appropriate for investigations in respect of the Market Rules. Even if they were, they should be powers of last resort and consistent with other regimes applied by the ACCC staff seconded to the AER and applying to industry participants.

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