Draft Decision

Approach to compliance with the National Energy Retail Law, Rules and Regulations

December 2010

AUSTRALIA
ENERGY
REGULATOR

Contents

Shortened forms

ACCC	Australian Competition and Consumer Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
APG	Australian Power and Gas
CALC	Consumer Action Law Centre
CCG	Consumer Consultative Group
CUAC	Consumers Utilities Advocacy Centre
ERAA	Energy Retailers Association of Australia
EWON	Energy and Water Ombudsman New South Wales
IPART	Independent Pricing and Regulatory Tribunal NSW
MCE	Ministerial Council on Energy
PIAC	Public Interest Advocacy Centre
QCOSS	Queensland Council of Social Services
Customer Framework	The National Energy Customer Framework, comprising the National Energy Retail Law, National Energy Retail Rules and National Energy Retail Regulations
regulated entity	Has the meaning given in s. 2 of the National Energy Retail Law—a retailer, a distributor or any other person identified in the National Energy Retail Rules as a regulated entity.
Retail Law	National Energy Retail Law
Retail Regulations	National Energy Retail Regulations
Retail Rules	National Energy Retail Rules

Introduction

The Australian Energy Regulator (AER) is an independent statutory authority that is part of the Australian Competition and Consumer Commission (ACCC). It monitors the wholesale electricity and gas markets and is responsible for compliance with and enforcement of the National Electricity Law and Rules and the National Gas Law and Rules. It also regulates electricity networks in the National Electricity Market (NEM) and gas pipelines in jurisdictions other than Western Australia.

The Ministerial Council on Energy (MCE) has developed a National Energy Customer Framework (Customer Framework) for electricity and gas distribution and retail regulation. The new Customer Framework is set out in the National Energy Retail Law (Retail Law), National Energy Retail Rules (Retail Rules) and National Energy Retail Regulations (Retail Regulations).[1] The National Energy Retail Law (South Australia) Bill 2010 was introduced to the Parliament of South Australia on 27 October 2010.[2] The MCE has also released the Retail Rules and Retail Regulations that will be made.[3]

The AER will be responsible for compliance with the Customer Framework.[4] The AER will monitor compliance by regulated entities—primarily energy retailers and distributors[5]—with the Retail Law, Regulations and Rules, investigate possible breaches and where necessary take action to enforce compliance. We propose to report regularly to stakeholders on our compliance activities and on levels of compliance in the market.[6] These functions will be underpinned by AER compliance procedures and guidelines (Procedures and Guidelines) developed in consultation with stakeholders. The AER will have information gathering and enforcement powers under the Retail Law to support its role.

On 31 May 2010 we published an issues paper on possible approaches to our new retail compliance functions. This draft decision has been developed in response to submissions received on that issues paper and further discussion at a stakeholder forum on 21 July 2010.

Discussion in this draft decision is presented in the following way:

- Parts 1 to 5 discuss our proposed approach to monitoring compliance by regulated entities with their obligations under the Customer Framework, including the way

---

1 Information on the development of the National Energy Customer Framework can be found on the MCE's website at http://www.ret.gov.au/Documents/mce/emr/rpwg/default.html.

2 National Energy Retail Law (South Australia) Bill 2010. http://www.legislation.sa.gov.au/LZ/B/CURRENT/NATIONAL%20ENERGY%20RETAIL%20LAW%20(SOUTH%20AUSTRALIA)%20BILL%202010.aspx

3 Ministerial Council on Energy Standing Committee of Officials – Bulletin No. 185. http://www.ret.gov.au/Documents/mce/_documents/2010%20bulletins/Bulletin%20No.%20185%20-%20%20National%20Energy%20Customer%20Framework%20Update.pdf

4 It is currently understood that the AER may not undertake this role in Western Australia, the retail electricity market in the Northern Territory and some retail gas markets.

5 Section 2 of the National Energy Retail Law defines 'regulated entity' as a retailer, distributor or other person identified in the National Energy Retail Rules as a regulated entity.

6 Section 204, National Energy Retail Law.

in which we intend to target our work, potential sources of information and the monitoring tools and mechanisms available to us.

- Part 6 discusses our investigative functions, and the process of enquiry and investigation that may follow the identification of a possible breach of the Customer Framework.

- Part 7 considers the role of enforcement action where the AER considers that a breach of the Retail Law or Retail Rules has occurred, and the enforcement options available to the AER.

- Part 8 sets out our proposed approach to publication of information and reports on our compliance activities and levels of compliance in the market.

- Part 9 discusses the appropriate level of AER guidance for regulated entities in their development of internal policies, systems and procedures to monitor their own compliance with the Customer Framework.

The positions presented in this draft decision are reflected in, and should be read in conjunction with, the Draft Statement of Approach to compliance with the National Energy Retail Laws, Rules and Regulations (Draft Statement of Approach) and Draft AER Compliance Procedures and Guidelines (Draft Procedures and Guidelines) released with this draft decision.

Call for submissions

The AER invites comments on the positions presented in this draft decision and in the attached Draft Statement of Approach and Draft Procedures and Guidelines. Responses to this consultation will inform the AER in its approach to compliance under the Customer Framework and the development of related procedures and guidelines.

Submissions can be sent electronically to: AERInquiry@aer.gov.auwith the title "Submission RE Retail Compliance – attn Christopher Streets", or by mail to:

General Manager, Markets Branch
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Submissions provided by email do not need to be provided separately by mail.

The closing date for submissions is 11 February 2011.

The AER prefers that all submissions be publicly available to facilitate an informed and transparent consultative process. Submissions will therefore be treated as public documents unless otherwise requested, and will be placed on the AER's website (www.aer.gov.au). Parties wishing to submit confidential information are asked to:

- clearly identify the information that is subject of the confidentiality claim

- provide a non-confidential version of the submission for publication, in addition to the confidential one.

The AER does not generally accept blanket claims for confidentiality over the entirety of the information provided. Such claims should not be made unless all information is truly regarded as confidential. The identified information should genuinely be of a confidential nature and not otherwise publicly available.

In addition to this, parties must identify the specific documents or relevant parts of those documents which contain confidential information. The AER does not accept documents or parts of documents which are redacted or 'blacked out'.

For further information regarding the AER's use and disclosure of information provided to it, please refer to the *ACCC–AER information policy: the collection, use and disclosure of information* on the AER website under 'Publications'.

1 Targeting monitoring activities

The issues paper released in May 2010 discussed the AER's role in monitoring compliance by regulated entities with the Customer Framework. To ensure that our monitoring activities prioritise those obligations that are most important to customers, and those that pose the greatest risk of breach, we explained our intention to conduct a detailed review of all obligations in the Retail Law and Rules.

We proposed a list of factors to be considered in assessing what the impact of a breach of each obligation might be, and how likely it is that a breach will occur.

We sought submissions on whether those factors were appropriate to an assessment of the potential impact of a breach and the likelihood of a breach occurring, and what other factors might be included.

1.1 Discussion of submissions

Submissions generally gave broad support to the targeted approach to compliance monitoring set out in the issues paper. A number of specific concerns were raised as to how the factors would be applied, and the role that this assessment was intended to play in the AER's monitoring regime and its investigative and enforcement roles. We explore these issues below.

How will the proposed approach to targeting monitoring activities allow the AER to detect breaches?

Submissions sought further information on how the proposed factors would allow the AER to detect breaches or possible breaches.

The assessment process itself will not operate as a monitoring tool that will detect breaches. Rather, the AER's assessment of obligations (by reference to the factors discussed above) is intended to guide us in selecting and applying appropriate monitoring mechanisms for that purpose. These mechanisms are discussed separately in parts 2–5 of this draft decision.

The assessment outcomes will allow the AER to focus on obligations most important to customers. The assessment is intended to identify obligations likely to have significant impact if breached, and those for which breaches can be expected to occur most frequently. The assessment is also intended to guide the AER in its selection of the most appropriate monitoring mechanisms. This will ensure that the mechanisms applied are appropriate to the risk associated with the obligation.

The factors we propose to use in the assessment process are discussed below, and included in the section 4.1 of the Draft Statement of Approach released with this draft decision.

Assessing the potential impact of a breach

How would a breach affect achievement of the National Energy Retail objective?

Each obligation in the Customer Framework works together to achieve the National Energy Retail Objective: to promote efficient investment in, and efficient operation and use of, energy services for the long term interests of consumers of energy with

respect to price, quality, safety reliability and security of supply of energy. Protecting customers in their dealings with energy retailers and distributors is a key part of this.

The extent to which a breach of an obligation would threaten or prevent the achievement of this objective will be relevant to any assessment of the impact of that breach. For example, where conduct or behaviour that breaches an obligation in the Retail Law or Rules would prevent the achievement of the National Energy Retail Objective and require significant intervention or corrective action by the AER, its likely impact would be relatively high. Where the breach of an obligation would have little consequence for the achievement of the objective, and the relevant conduct would require limited intervention or correction, it may have a relatively low impact.

What mechanisms or safeguards are in place to rectify a breach if it occurs?

In many cases, mechanisms and safeguards may be in place to effectively rectify damage caused by isolated breaches. For example, the Retail Law requires regulated entities to develop and apply standard complaints and dispute resolution procedures and to cooperate in facilitated resolution of customer disputes by an energy ombudsman. Distribution businesses may also be required to participate in a small claims compensation regime for specified complaints. In other cases, the Retail Law or Retail Rules may provide a partial solution themselves (e.g. by rendering non-compliant contracts invalid, so that they are not binding on energy customers).[7] Where breaches of an obligation are likely to be isolated rather than systemic, and mechanisms and safeguards are in place to correct or rectify a breach without the need for regulatory intervention, the impact of such a breach may be reduced relative to other breaches that can only be remedied by the AER.

How many people are likely to be affected by a breach of the obligation?

The Customer Framework operates to protect the interest of individual customers in their dealings with regulated entities. However, some breaches will by their nature have a widespread impact, while others are likely to have a more confined impact.

The greater the number of customers likely to be affected by a breach, the greater the overall impact of that breach may be (relative to other breaches). A breach of a provision requiring that standard retail contracts comply with the model terms and conditions in the Customer Framework would by its nature have a widespread effect due to the number of customers likely to be party to such contracts. Alternatively, a breach of a provision requiring that consumption information be provided to an individual customer on request would be confined to the customer who had requested the information. Whilst both are breaches that we would seek to rectify, the type of monitoring mechanism and intensity of review applied might differ. This is because the second example has a narrower impact.

How are people likely to be affected by a breach of the obligation?

In assessing the potential impact of a breach on customers and/or other regulated entities, the AER may consider the following types of questions:

---

[7] ss. 29, 36, National Energy Retail Law.

- Would a breach of the obligation hinder or prevent customers' access to essential electricity or gas services?

- What is the likely financial impact of a breach on customers and/or other regulated entities?

- Are there special considerations that would magnify the impact of a breach? (for example, does the obligation relate to customers on life support, or disadvantaged or vulnerable customers?)

- What is the likely impact of a breach on the operation or competitiveness of the retail market? (for example, does the breach give one regulated entity an artificial competitive advantage over others?)

- Is the breach likely to impact on another party's ability to comply with its own obligations under the energy laws?

- Is the breach likely to create a significantly increased workload for other retail market participants or agencies? (for example, the AER, the energy ombudsman, customers, other regulated entities?)

Assessing the likelihood of a breach

What are the incentives driving compliance behaviour?

The Customer Framework creates obligations and requirements that seek to direct or constrain the behaviour of regulated entities in the energy market. In its assessment of the likelihood of a breach of a particular obligation, the AER will consider behavioural incentives (and disincentives) to comply with that obligation. Where there is a strong incentive to comply, the AER's monitoring is likely to be less intrusive. For example, if a breach will be highly visible and damaging to a regulated entities reputation, there may be a strong incentive to comply.

Awareness of the Customer Framework

Significant parts of the new Customer Framework reflect existing obligations imposed by State and Territory energy laws. Regulated entities can reasonably be expected to be aware of these obligations, and to have systems and procedures in place to manage their compliance. The likelihood of such obligations being breached through lack of awareness should therefore be limited.

However, a number of the obligations imposed by the Customer Framework are new to some or all regulated entities. Other obligations, while broadly familiar, may depart slightly from existing obligations in detail and therefore require adjustments to current business practices to ensure compliance. In the early stages of operation of the Customer Framework, awareness of such obligations may be lower than that of pre-existing requirements, making the likelihood of a breach higher.

We consider it appropriate to devote greater attention to monitoring compliance with new obligations in the transitional period, until a pattern of acceptable compliance is achieved. Identification of new obligations that pose a relatively high compliance risk by reference to this and other factors will allow the AER to work cooperatively with

regulated entities, to ensure that appropriate systems and processes are developed to reduce the likelihood of breaches occurring. Over time, amendments to the Retail Law and Retail Rules that introduce new obligations or alter existing ones will be considered in the same way.

This does not mean that those new obligations that may be a higher compliance risk would necessarily receive additional attention from the AER in terms of its enforcement activities. When a breach of an obligation is identified, we may have regard to the length of time that the obligation has been in place. We may also consider the time that a regulated entity has had to develop appropriate systems and procedures to ensure compliance, when determining what action to take in response to that breach.

Past compliance performance

Historical levels of, and patterns in, compliance with an obligation—including compliance with similar obligations prior to commencement of the Customer Framework—may inform the AER's assessment of the likelihood of future breaches. For example, we may apply greater scrutiny to obligations with which past compliance has been relatively poor. On the other hand, obligations for which there has historically been a strong level of compliance, or in which efforts to improve on past compliance have been successful, may attract lighter scrutiny.

Past levels of compliance and trends in compliance levels over time, can provide a useful indicator of likely behaviour in the future. Whether across the whole industry or isolated to one business, obligations that have a record of prior breaches are of key concern for the AER. By monitoring these areas we seek to ensure that repeated breaches are prevented, and that any actions taken by a regulated entity (or the industry as a whole) to rectify compliance issues have been effective.

Regulated entities are encouraged to share such initiatives with the AER. We also proposed to require regulated entities to include details of corrective measures and systems improvements in their periodic reports to the AER and in response to targeted reviews or audits.

How will the period of transition to the new Customer Framework be recognised in the targeting process?

TRUenergy and ActewAGL both noted that during the implementation of the framework, there would likely be a higher instance of breaches of the Customer Framework as companies come to understand new obligations imposed. TRUenergy suggested that it would be inappropriate for the AER to undertake a heavy handed approach to enforcement during the implementation of the Customer Framework.

As we recognised in the issues paper, many obligations in the new Customer Framework reflect existing obligations in jurisdictional energy laws. We do not anticipate a significant period of adjustment will be required for regulated entities to ensure that systems and procedures are in place to meet such obligations. Other obligations in the Customer Framework will be new to some or all regulated entities. Awareness of those obligations may be lower and a period of transition could be expected before systems are adjusted to reflect the requirements of the new Customer Framework. In the short term, while regulated entities become familiar with such

obligations, breaches may be more likely to occur. We consider it appropriate to devote greater attention to monitoring compliance with new obligations during the transitional period, until a pattern of acceptable compliance is achieved. This position is reflected in section 4.1 of the Draft Statement of Approach.

The AER will work cooperatively with regulated entities during transitional periods to ensure that appropriate systems and processes are developed to reduce the likelihood of breaches occurring. In the event that a breach of any obligation is identified, the AER may have regard to the length of time that the obligation has been in place, and the time that a regulated entity has had to develop appropriate systems and procedures to ensure compliance. The considerations that are likely to inform the AER's decisions on enforcement action are discussed separately in part 7 of this draft decision.

The need for a balanced approach to assessing past compliance

Both AGL and APG were concerned by the AER's intention to consider past compliance performance when deciding how to target its monitoring activities. Their submissions cautioned the AER against making decisions based on past poor performance without also considering any subsequent actions taken by a regulated entity to address the issues.

Past levels of compliance, and in particular trends in compliance levels over time, can provide a useful indicator of likely behaviour in the future. We will monitor these areas not only to mitigate against future breaches, but also to ensure action taken to rectify identified breaches were effective. Greater scrutiny may be applied to obligations with which past compliance has been relatively poor, but obligations for which there has historically been a strong level of compliance may attract lighter scrutiny. In each case, we propose to take into account the circumstances surrounding past periods of high or low compliance, including any steps taken by regulated entities in response to periods of poor compliance.

Impact of a breach on administrative costs and workload of ombudsman schemes and other agencies

In considering how people are likely to be affected by a breach of an obligation, the issues paper proposed to look at whether the breach would create unjustified administrative costs for others. EWON submitted that consideration of the impact of a breach might be better targeted by assessing the likelihood that a breach would result in a significantly increased workload for other agencies. EWON submitted that this term more accurately reflected industry experience for both customers and stakeholders. EWON's suggestion is now reflected in section 4.1 of the Draft Statement of Approach.

1.2 Summary of position

The AER's proposed position received broad support, and we have further refined our intended approach in response to submissions received.

The targeting process is designed to ensure that our approach to monitoring compliance with obligations under the Retail Law and Retail Rules is appropriate for the risks it seeks to address. We will publish information on our proposed process in our Statement of Approach. The targeting process will involve a case-by-case

assessment of each obligation with consideration given to potential impact of a breach, and the likelihood that it will occur. Factors we are likely to consider, including those discussed above, will be listed to provide transparency for stakeholders.

Our proposed approach to targeting our retail compliance monitoring activities, and the considerations that may inform this approach, are set out in section 4.1 of our Draft Statement of Approach.

2 Market intelligence and information

In the issues paper the AER outlined various sources of information that may assist in monitoring compliance with the Customer Framework.

The AER sought submissions as to whether the use of these information sources would be appropriate and effective as an input into the AER's compliance monitoring activities. Stakeholders were also invited to suggest additional sources of information that the AER should consider.

2.1 Discussion of submissions

There was broad support from consumer groups and from EWON for the information sources set out in the issues paper. However, retailers and distributors were concerned by our proposal to consider information on complaints made to energy ombudsman schemes and other agencies, and a perceived focus on what they considered to be anecdotal evidence. They sought clarification of the way in which the AER intended to use information on customer complaints, and suggested that reliance on such information needed further consideration.

CALC supported the use of information from energy ombudsman schemes to alert the AER of emerging issues. It suggested that regular reports and meetings will be essential if the AER is to be informed of trends and issues in the retail market, and recommended consideration of this in memoranda of understanding between the AER and the ombudsman schemes. CALC also recommended similar relationships with Consumer Affairs Victoria and its counterparts in other jurisdictions, and proposed tripartite arrangements with the ACCC to manage the overlap between the Customer Framework, the Australian Consumer Law and the *Trade Practices Act 1974* (Cth).

CALC also referred the AER to procedures developed by the ACCC to escalate complaints received from consumer groups or agencies directly to a preliminary investigation stage. It suggested that these organisations tend to be more expert regarding the role of the regulator than the general community, and have therefore effectively already applied a filter in determining which matters to refer to the regulator for attention. CALC also acknowledged the role of the AER's Customer Consultative Group. On the other hand, it cautioned against over reliance on peak bodies to the exclusion of direct input from customers. CALC recommended the AER prioritise direct engagement with customers.

PIAC proposed several other avenues for gathering information. It suggested that the AER work with retailers to access their internal disputes data and explore ways to make this data public where possible. PIAC also proposed the AER monitor reports and data produced by the jurisdictional regulators and community sector research. The extensive research undertaken by community groups on the impacts of energy policy was also identified as a useful resource in monitoring potential compliance issues.

These suggestions will be incorporated into our proposed approach to monitoring compliance with the Customer Framework. There are, however, a number of reservations raised by stakeholders as to how we can ensure that our interpretation of

and response to information of this nature is objective and provides a reasonable opportunity for regulated entities to be heard.

Submissions from the ERAA and a number of individual retailers and distributors raised concerns with the AER's use of information on complaints (in particular from sources such as energy ombudsmen schemes, the CCG or the ACCC/AER call centre) as an indicator of a possible breach or breach. They cautioned against assuming that a complaint was evidence of an underlying breach. They further emphasised the importance of discussing the nature of any complaints, and the outcomes of complaints, with the relevant regulated entity before conclusions were drawn. Submissions from regulated entities also questioned the reliability of complaints data published by ombudsman schemes, which may overstate the number of complaints where issues related to dual fuel customers or where the complaint was assigned to multiple categories. Citipower and Powercor noted the detrimental impact such data could have on a regulated entity's reputation if misrepresented in public reports. Again, such data was considered useful only where it was fully understood and where retailers had an opportunity to respond.

The Customer Framework is designed to protect customers in their dealings with energy retailers and distributors, and create an environment in which they can confidently engage with regulated entities. Where customers are driven to complain about their energy services, it may be that their concerns are driven by weaknesses in regulated entities' compliance with the Retail Law or Rules. This will not always be the case. Retailers are correct in their observation that complaints may simply reflect dissatisfaction with a level of service that is nonetheless fully compliant with the relevant obligations under the Customer Framework. We are aware of the limitations of complaints data reported by agencies such as energy ombudsman schemes and consumer and community groups—and of complaints made directly to the AER— as definitive indicators of a possible breach or breach. However, as a signal that something may be amiss, we consider this data to be a valuable trigger for the AER to explore an issue further with the regulated entities concerned. Our proposed use of this information should be understood in that context.

Complaints may or may not point to an underlying issue of compliance. The first step in consideration of complaints data is therefore to understand the nature of complaints and the circumstances in which they have arisen. The AER established memoranda of understanding with energy ombudsman schemes in each participating state and territory in July 2009.[8] We are working closely with those schemes to ensure that we can consider complaints data reported publicly or directly to the AER in the context of their individual record keeping systems. With this robust platform for interpretation, we will be able to identify those areas of complaint that require further examination, and to work with both the ombudsman scheme and the regulated entities concerned to determine the circumstances surrounding those complaints. It is this process of examination and discussion, and not the complaints data that led us to initiate it, that will allow us to identify breaches or possible breaches that warrant further enquiry or investigation.

---

[8] The AER's memoranda of understanding with energy ombudsman schemes are available on its website at http://www.aer.gov.au/content/index.phtml?itemId=729665.

2.2 Summary of position

We propose to collect and monitor information from regulated entities, customers, consumer groups, energy ombudsman schemes and other agencies such as AEMO for signs that breaches of the Customer Framework may be occurring.

This information will be an important part of our compliance monitoring regime. We recognise that the value derived from market information and intelligence will be dependent on our ability to interpret it objectively and reliably and to explore the relevant circumstances with all parties concerned.

The development of systems and processes to capture and analyse market intelligence information has been, and continues to be, a priority for the AER.

3 Targeted compliance reviews

The issues paper proposed a system of targeted compliance reviews to monitor compliance with obligations under the Customer Framework. A similar system is currently used by the AER to monitor compliance with the National Electricity and Gas Rules.

The purpose of the proposed reviews is to measure compliance, but also to explore and assess compliance practice, policies, systems and procedures for a particular obligation, or a group of related obligations. While the primary purpose of targeted reviews is to monitor compliance, they also serve an educative purpose for both regulated entities and the AER.

Where targeted reviews identify possible breaches of the Customer Framework, further enquiries and investigation are likely to follow.

Obligations would be selected considering factors such as recent market events and observed patterns or trends in compliance or customer complaints, or changes to the Customer Framework that vary existing obligations or introduce new ones (for example, rule change determinations by the AEMC).

Stakeholders were asked to consider whether targeted reviews would be a useful tool for monitoring compliance in the retail market, and what changes (if any) could be made to tailor the AER's existing approach to these reviews.

3.1 Discussion of submissions

The AER received broad support for the use of targeted reviews. QCOSS and CUAC supported the use of targeted compliance reviews, with CUAC advocating a particular focus on customer hardship policies.

TRUenergy, UED Multinet, Powercor, Citipower and Origin Energy also supported the proposal of targeted compliance reviews. However, they joined the ERAA in expressing concern about the reporting burden created by this approach, particularly if these reviews are conducted quarterly basis as they have been in wholesale energy markets. The ERAA questioned the intention of such reviews, while AGL opposed their application in the absence of evidence of market failure.

Targeted compliance reviews have been used to monitor compliance in the electricity wholesale markets since the commencement of the national electricity market in 1998. The reviews have been successfully introduced into the declared wholesale gas market from mid 2009. These reviews have yielded positive results.

The model for targeted compliance reviews we now propose is flexible in its application, with reviews likely to occur at least every six months to allow an extended period of consideration. Participation is intended to be balanced over time so that an individual retailer or distributor can expect to be involved in at least one targeted review each year. For example, we may choose to conduct a rolling review of obligations and regulated entities that is completed over time, rather than a single review of all obligations or all regulated entities in the same period. Reviews are likely to target areas in which the AER has cause for concern, and in which there is potential to clarify the operation of the Customer Framework and explore ways to

improve compliance practice. In this context, we consider a program of six-monthly reviews reasonable. However, where there is no call for such a review in a particular period, or where a particular review warrants an extended period of exploration and/or the participation of other parties such as energy ombudsman schemes, the frequency of such reviews may be reduced.

Such reviews can provide a cost effective substitute for more intensive and onerous information gathering processes such as audits or investigations. However, participation in such reviews is voluntary and regulated entities could elect not to take part. The AER's experience with targeted compliance reviews has shown them to be an effective way to communicate with industry about areas of concern. Feedback on the targeted review process from wholesale market participants suggests they are a useful educative tool and a valuable source of information on industry best practice. The reviews have provided a regular forum for businesses to engage with the AER and provide information on the processes and methods they have in place to ensure compliance. In this way, targeted compliance reviews provide a combination of evaluative and educative benefits to the market.

3.2 Summary of position

The AER proposes to include a program of targeted compliance reviews in its retail market compliance monitoring activities. These reviews would focus on the compliance systems and procedures that regulated entities use to manage their compliance with the targeted provisions or obligations. The results of these reviews may be published to provide information on the operation of the Customer Framework and industry best practice in compliance management. Where the AER does publish the outcomes of a targeted review, it would only release information that was of a general or public nature, and would not publish any confidential information.

We propose to conduct reviews at least once every six months, with the scope pf each review determined with regard to recent market events, observed patterns or trends in compliance or customer complaints. Where appropriate, a review may be extended to examine relevant information from other parties including energy ombudsman schemes to ensure that the process is as robust and comprehensive as possible.

4 Retailer and Distributor reporting

The issues paper proposed an exception reporting framework that requires regulated entities to submit periodic reports on any breaches or possible breaches of selected obligations, and identifying any breaches that occurred within the relevant reporting period.

The AER did not propose to attach reporting requirements to all obligations in the Customer Framework. Instead, we proposed to consider all obligations and identify those for which other information sources were likely to be insufficient, so that reporting obligations were required to gather the necessary information.

Those areas of the Retail Law and Rules selected on this basis would then be divided into three tiers based on the severity of a potential breach and the likelihood that that the impact will escalate in the short, medium and long term if no action was taken. Each tier would carry a different reporting frequency (immediate, quarterly or six monthly, and annually).

4.1 Discussion of submissions

There was broad support for the use of a tiered approach to exception reporting. However, specific concerns were raised in relation to the frequency of reporting and its implications for the administrative burden placed on regulated entities. Submissions sought further clarity in the definitions of each tier, and the nature of obligations that would fall within them. Stakeholders also raised a number of issues on the reliability of information collected under a self-reporting regime and appropriate mechanisms for quality assurance.

Classification of obligations and clarification of reporting tiers

Origin noted that the AER needed to clearly articulate what may constitute a potential to threaten public health or safety to avoid setting inappropriate reporting obligations for provisions without material effect.

EWON noted that the tiers used by IPART under its exception reporting regime included a wider definition of what constituted a first tier obligation. It recommended including breaches that would have a critical impact on the government's policy objectives over time, and breaches with an impact that would increase over time if not rectified quickly. EWON also noted potential ambiguities between the proposed tier 2 and 3 definitions, suggesting that conflicting considerations may arise in assessment of obligations.

AGL questioned the value of considering the number of customers likely to be affected by a breach, when what may constitute a large number of customers for one retailer may be a small percentage of the customer base of another.

Obligations selected by the AER for reporting obligations will be identified in the AER Compliance Procedures and Guidelines.

The broader application of immediate reporting requirements proposed by EWON is consistent with that taken in exception reporting frameworks applied by most jurisdictional energy regulators. It can reasonably be applied to the Customer

Framework. The AER has revised its proposed approach to identification of type 1 obligations to capture those obligations for which breach would have a critical impact on customers and where the impact is likely to escalate in the short (one to three month) term if not remedied quickly. When considering which obligations fall into this category, we propose to have particular regard to obligations which are critical to the policy intent of the Customer Framework, as reflected in the National Energy Retail Objective.

Type 2 regulatory obligations will be those obligations where breach is likely to have a serious impact on customers, which is likely to escalate or become widespread in the medium (three to six month) term if steps are not taken to rectify it.

Type 3 regulatory obligations will be those where breach is likely to have a low or limited impact on customers, but may escalate or become widespread in the long (six to 12 month) term if not rectified.

While the proportion of a customer base is a useful indication of the materiality of a breach to the relevant regulated entity, our intent is to direct our classification of obligations to breaches with a significant or widespread impact on customers, even where they may comprise only a relatively small proportion of a regulated entity's customer base. In refining our proposed approach to classification of obligations we have focussed on the impact on customers rather than a purely quantitative measure of materiality.

Citipower and Powercor sought direction from the AER as to what compliance measures would be required for high volume, process driven tasks. In their joint submission they argued that it would not be practical for regulated entities to report every instance of a breach with these types of obligations. We are aware that breaches can and will occur from time to time, and that breaches of obligations relating to high volume tasks are more likely to occur in part because there is more opportunity for error. However, for the same reasons such breaches may be prone to systemic failure if not addressed in a timely way. The importance of a breach should not be down-played simply because it is more likely to occur. In such cases systems should be in place to ensure the quality of service delivery in high volume, process driven tasks, and to identify breaches when they occur to ensure that breaches do not escalate to become systemic.

At this time, we do not propose to define compliance with obligations governing high volume, process driven tasks any differently for compliance monitoring purposes than compliance with other obligations in the Retail Law and Rules. However, the AER may consider introducing a threshold for reporting breaches or possible breaches for high volume, process driven tasks after an initial period of observation. Information and data collected through monitoring and reporting mechanisms during that period would be used to determine the appropriate threshold.

Frequency of reporting

CUAC stated a preference for regulated entities to report to the AER immediately in the event of a serious breach, with quarterly and annual reporting for other identified provisions. However, the ERAA argued that quarterly reporting would create too high a burden on regulated entities, and would provide the AER with data of limited value particularly during the period of transition to the Customer Framework. This view

was shared by retailers. AGL suggested that a quarterly reporting cycle would not allow sufficient time to investigate breaches, possibly resulting in inaccurate information. Jemena shared the view that quarterly compliance reporting would create an inappropriate burden on regulated entities. It suggested that reporting on an immediate, six-monthly and annual basis may be an appropriate alternative. IPART also noted that it had scaled back its reporting requirements so that regulated entities now report annually for most obligations, with limited exceptions (noted above) where immediate reporting remains.

When considering the time required by regulated entities to detect, investigate and report a relevant breach, and that required for the AER to review each matter and determine an appropriate course of action, the utility of quarterly reporting may be limited. We have reviewed our position and now propose a requirement for immediate, six-monthly and annual reporting for type 1, 2 and 3 obligations respectively. We acknowledge that longer time periods between reports on type 2 breaches could mean that an issue takes longer to become apparent if reports from retailers and distributors are relied on as the only mechanism for compliance monitoring. However, exception reporting is only one of the many monitoring mechanisms we intend to employ. When supported by market intelligence and information, surveillance of regulated entities' websites, targeted compliance reviews and audits, we consider 6-monthly reporting on type 2 obligations is likely to be sufficient. This position can be reviewed over time if evidence emerges to the contrary.

Various submissions suggested that reporting requirements be altered for individual regulated entities to take into account their past compliance practices. IPART noted the benefits of a flexible approach that allows the regulator to reward good compliance with reduced reporting obligations, and to increase reporting requirements for regulated entities with high levels of breaches or potential breaches. This approach can provide constructive incentives to regulated entities. It can also be used to ensure that the cost of more frequent reporting is borne only by those regulated entities for which heightened scrutiny will create clear benefits in awareness and accountability.

We have incorporated a process for amendments to reporting requirements for individual regulated entities into the Draft Procedures and Guidelines published with this draft decision. This process would allow us to reduce or increase the reporting frequency for some or all type 2 and 3 obligations in response to observed patterns of compliance over time. Section 3.6 of the Draft Procedures and Guidelines proposes a structure within which the AER will determine whether an adjustment to the frequency of reporting by an individual regulated entity is warranted, and the process for making such a variation.

Quality assurance and verification of information reported

Stakeholders raised several issues in respect of the policies and systems regulated entities should use to report data to the AER. CALC and EWON pointed to apparent discrepancies between the number of breaches reported by regulated entities to jurisdictional regulators and the complaints data recorded by ombudsman and by regulators themselves. Some differences between complaints data reported by ombudsman schemes and compliance data reported by regulated entities under the Procedures and Guidelines is inevitable. This is because a complaint will not always

relate to a breach of the Customer Framework. The AER will work closely with ombudsman schemes in each jurisdiction to ensure that it can reliably interpret patterns in complaints data. This will allow us to identify any anomalies between complaints data and data on compliance submitted to us by regulated entities under the Procedures and Guidelines.

TRUenergy queried the level of clearance required for compliance reports submitted to the AER, suggesting that high level approvals were unnecessary and would slow down the exchange of information with the AER. It argued that staff providing the information will be suitably placed to know which issues require the attention of senior staff, and that information provided would be accurate whether provided by the Chief Executive Officer (CEO) or any employee to whom such responsibility had been delegated.

In determining the appropriate level of clearance for a compliance report submitted by a regulated entity to the AER, we are concerned not only with the accuracy of the information provided, but with the level of accountability for reported levels of compliance. We consider it reasonable to expect that a report submitted to the AER as a record of breaches of the Customer Framework, and by exception as an assurance of compliance in other respects, would be reviewed and acknowledged by the CEO (or an officer with similar responsibility for corporate behaviour). This expectation is consistent with the principles of commitment to effective compliance by the governing body and top management of a regulated entity outlined in AS 3806.[9] In developing the reporting framework proposed the Draft Procedures and Guidelines, we have taken the requirement for endorsement by a regulated entity's CEO into account in proposing timeframes for the submission of reports.

4.2 Summary of position

We propose to apply a targeted framework of exception reporting to obligations under the Customer Framework for which we consider other sources of information are likely to be insufficient.

Obligations identified by the AER as requiring a reporting obligation will be classified as one of three types:

- Immediate reports will be required for those regulatory obligations where the AER considers a breach is likely to have a critical impact on customers, which is likely to escalate or become widespread in the short (one to three month) term if it is not rectified quickly (Type 1 obligations).

- Six-monthly reports will be required for regulatory obligations where the AER considers a breach is likely to have a serious impact on customers, which is likely to escalate or become widespread in the medium (three to six month) term if steps are not taken to rectify it (Type 2 obligations).

- Annual reports will be required for regulatory obligations where the AER considers a breach is likely to have a low or limited impact on customers, but is

[9] Australian Standards – Compliance Programs – AS 3806 – Second edition 2006

likely to escalate in the long (six to 12 month) term if not rectified (Type 3 obligations).

We propose to review these timeframes periodically. The Draft Procedures and Guidelines also provide for the frequency of reporting to be varied for individual regulated entities in response to their compliance performance. Such variation will be made pursuant to an objective review of compliance performance against measureable criteria set out in the Draft Procedures and Guidelines.

Our proposed approach to exception reporting is set out in section 4.2.4 of the Draft Statement of Approach. The reporting framework developed to implement this approach is set out the Draft Procedures and Guidelines.

5 Compliance audits

The Retail Law allows the AER to require a regulated entity to undertake an audit of its compliance with the Customer Framework. The AER can also conduct such an audit itself, or arrange for a third party to conduct such an audit on its behalf. The issues paper noted that audits can vary in scope, and proposed that the timing and scope of any audit be determined on a case by case basis. We sought submissions from interested parties on relevant factors for determining when an audit should take place and the scope of such an audit. In addition, submissions were sought on what factors would be relevant in deciding whether an audit should be conducted by or on behalf of the AER, or by the relevant regulated entity.

The Customer Framework provides for the costs of a compliance audit to be borne by the relevant regulated entity or entities. Where an audit is conducted or commissioned by a regulated entity at the request of the AER, those costs will be managed by the entity itself. However, where the AER engages a contractor or other person to conduct an audit on its behalf, the AER will seek to recover those costs from the regulated entities concerned. In procuring the services of an independent auditor the AER will be subject to the requirements of the *Financial Management and Accountability Act 1977* (Cth). We sought submissions on whether standardised payment arrangements and default periods for payment were appropriate. We also sought suggestions on how cost allocation should occur if a single audit covers more than one regulated entity.

The issues paper also discussed the Retail Law provision for audits of the performance of retailers' customer hardship programs by reference to the national hardship indicators. We proposed that any such audit be combined with an audit of compliance with the relevant provisions of the Retail Law and Rules.

5.1 Discussion of submissions

Submissions offered different positions on what constituted an audit, how audits should be conducted and what cost recovery mechanisms might be appropriate.

When should an audit be required?

Consumer groups proposed several approaches to undertaking audits. CUAC and CALC suggested that audits should be performed on a planned and scheduled basis, with CUAC suggesting a particular focus on new entrants. CALC asserted that the AER should document the process for managing audits and their results as well as publishing the results of audits. CUAC recommended a program of annual audits, but noted that the scope, detail, timing and coverage of an audit could be different for regulated entities with a history of compliance issues. QCOSS agreed that audits should be conducted often and on an ongoing basis, but recommended an element of unpredictability to convince regulated entities to comply with all obligations, and not just those most likely to be targeted.

ActewAGL, AGL, Origin, Citipower and Powercor all supported the proposal that the decision to conduct an audit should be made on a case-by-case basis. They recommended that an audit only be required where the AER has reason to believe there is a material compliance issue. UED Multinet and Jemena both argued that due to the cost and burden imposed by audits, they should be performed no more than once per year. Jemena suggested that audits should only be performed more

frequently where the AER has identified systemic issues that could result in significant consequences if not investigated in the short term. Origin suggested separately that the period of June/July was an inconvenient time to audit due to financial constraints surrounding the end of financial year period.

The value of compliance audits is widely recognised. The purpose of a compliance audit is to conduct a full review of the existence and effectiveness of the internal policies, systems and procedures used by regulated entities to ensure that they are aware of their obligations and have appropriate internal control mechanisms in place for identifying, monitoring and ensuring compliance, and identifying breaches or possible breaches. To meet these objectives, a compliance audits may include a review of:

- historical levels of compliance, including compliance reports submitted to the AER
- the effectiveness and maintenance of compliance systems, policies and procedures used by the regulated entity to monitor its compliance with the Customer Framework
- the levels of responsibility and communication protocols for compliance.

Used correctly, a compliance audit is an effective monitoring mechanism. It adds further value as an educative process through which customers and regulated entities can be informed about industry best practice in compliance with the Customer Framework. All stakeholders accepted that auditing can involve significant costs and is likely to demand significant resources for both the relevant regulated entity and the AER itself. Our intention is therefore to use audits in a way that maximises their value to both the regulated entities being audited and the market as a whole.

We do not propose to adopt a fixed program or schedule of compliance audits. Instead, the decision that an audit is appropriate will be made on a case-by-case basis. Audits will be required in response to issues identified through other compliance monitoring activities. They will be directed to areas of identified concern. The full range of information sources available to us will guide our decisions. This includes market intelligence and information, targeted reviews and reporting mechanisms discussed in the previous sections of this draft decision. The AER may use a single audit to target a number of issues, rather than a series of audits on individual matters. In this way, we expect that no individual retailer or distributor would be audited more than once in a 12 month period. However, if circumstances are such that there is a clear benefit to customers and the market in more frequent audits we do not consider such action to be precluded.

How should the scope of an audit be determined?

ActewAGL and AGL submitted that the factors that would inform the AER's decision on the scope of a particular audit should form part of the Procedures and Guidelines, and should include consultation with the relevant regulated entity. Citipower and Powercor suggested that these factors should include the materiality of the breach or suspected breach, the costs of the audit, and areas that have been affected. QCOSS advocated an element of unpredictability in the targeting and scope of audits. It

suggested that this would create a stronger incentive on regulated entities to comply with all obligations, and not just those most likely to be targeted. CALC and CUAC noted the relevance of the compliance history of the relevant regulated entity as a determinant of scope, and the fact that the appropriate scope of an audit is best determined with regard to the issue or issues it seeks to address.

The Draft Procedures and Guidelines record our intention to consult with the relevant regulated entities on the appropriate scope of a compliance audit.

When should audits be conducted by regulated entities, and not by the AER?

Citipower and Powercor suggested that an audit seeking to review compliance issues of a minor or lesser impact would be more appropriately arranged by the relevant regulated entity at the request of the AER than by the AER or an independent auditor engaged on our behalf. Origin agreed that in circumstances where the AER is confident that the regulated entity has the ability and willingness to conduct a self-audit, then this should be the preferred option.

We recognise that internal audits managed by regulated entities are likely to be more appropriate in some circumstances. This is particularly so where an audit targets an individual retailer or distributor, and the issues of concern are narrow and their impact can be readily contained. It may also be appropriate where the regulated entity has demonstrated that it has conducted transparent and independent compliance audits in the past. Requiring regulated entities to audit and evaluate their own compliance systems is consistent with the AER's view that retailers and distributors are responsible for ensuring their own compliance with the Customer Framework. Regulated entities should not be dependent on the AER for such assessments. In such circumstances we would cooperate with the relevant regulated entity or entities in setting the scope and timing of the audit, and would ensure that they are held accountable for the quality of the review by requiring the full report of the audit to be submitted to the AER for evaluation when completed.

The factors that the AER proposes to take into consideration in deciding the most appropriate audit mechanism are set out in clause 4 of the Draft Procedures and Guidelines published with this draft decision. Proposed requirements to conduct any audit in accordance with the agreed scope and to disclose the full findings of such audits to the AER are also set out in clause 4.

Recovery of audit costs by the AER

One of the key issues covered by submissions was that of cost recovery for audits conducted by or on behalf of the AER. The Customer Framework allows the AER to recover these costs from the relevant regulated entity.

Jemena and UED Multinet strongly objected to any proposition that audit costs should be recovered from regulated entities. They argue that, where the AER selects the auditor to be used rather than allowing a regulated entity to engage the auditor of their choice, costs should be recovered from the AER's budget. They went on to submit that where the AER does decide to recover the costs from a distribution business it must consider what allowance has been made in the relevant price determination for such audits, and that where no allowance has been made, the AER should not seek to recover such costs.

Where multiple regulated entities are captured under the one audit, several submissions expressed broad support for a case-by-case review of how those costs should be allocated. There were different views on how such a review should be conducted. AGL and TRUenergy stated a preference for costs to be allocated specifically to each party according to the costs required in auditing that party alone. Origin argued that all parties should share costs equally as audits will generally be process driven.

Citipower, Powercor and CUAC all supported the development of standard payment arrangements and default periods for payment. AGL and Origin preferred such arrangements to be determined as part of the case-by-case planning of each proposed audit.

The Retail Rules allow the AER to recover the costs of any compliance audit conducted by or on behalf of the AER from the relevant regulated entity or entities. It is our intention to do so, particularly where the circumstances justify the engagement of an independent auditor by the AER. As explained earlier in this section, the AER intends to use audits in response to identified areas of concern in relation to a regulated entity's compliance performance, so that the potential to incur the costs of an audit should itself be considered an incentive to maintain appropriate levels of compliance. In keeping with its decision to determine the scope and timing of compliance audits on a case-by-case basis, the AER sees advantages in retaining some flexibility around the arrangements of the recovery of these costs to allow for a similar case-by-case review. However, we appreciate that regulated entities need transparency and predictability in how audit costs will be recovered to manage their expenditure over time. Clause 4 of the Draft Procedures and Guidelines therefore establishes both default arrangements for the timing of cost recovery and the flexibility to depart from those arrangements by agreement. Where a single audit covers multiple regulated entities we propose to determine the appropriate allocation before the audit commences, and to provide for the costs of any such audits to be itemised by reference to each regulated entity.

Should audits of retailer compliance and performance of retailer hardship programs be combined?

TRUenergy and AGL supported combining compliance and performance audits of retailer hardship programs where it would lead to more efficient processes and lower costs for regulated entities. CALC, CUAC and QCOSS also supported this proposal, agreeing that such an approach would provide a more holistic and effective review and potentially result in a lower overall cost. However, Origin did not consider such a combination appropriate unless any resulting reports released by the AER made it clear which areas of the review related to compliance as distinct from performance.

We retain the view that audits of a retailers' compliance with obligations in relation to hardship customers and the implementation of their hardship policies are best combined with an audit of the performance of retailers by reference to the hardship program indicators determined by the AER. An assessment of how well a retailer's hardship policy is performing is likely to rely on an initial assessment of whether that retailer is complying with their hardship obligations and the primary obligation to implement the policy. We are conscious of the distinction between an assessment of a retailer's compliance with its legal obligations and a measurement of its performance

against established indicators. As explained earlier in this section, our intention is to engage with retailers and other stakeholders in settling the scope of any audit we conduct. Measures necessary to distinguish between compliance and performance assessments can be considered as part of this process to ensure that any audit is appropriately targeted and that the results are clearly communicated to the market.

5.2 Summary of position

We propose to adopt a flexible approach to compliance auditing that allows decisions on the appropriate audit mechanism and the timing and scope of an audit to be made on a case-by-case basis.

The Draft Procedures and Guidelines published with this draft decision set out the process by which the AER proposes to conduct these case-by-case assessments, and provide a list of considerations that will inform the AER's decisions. The Draft Procedures and Guidelines also establish default arrangements for the recovery of audit costs incurred by the AER. We intend to engage with regulated entities and other stakeholders as appropriate on our approach to each audit undertaken.

Our proposed approach to compliance audits under the Customer Framework is set out section 4.2.5 of the Draft Statement of Approach. The framework in which such audits will be conducted, and provisions for cost recovery, are set out in clause 4 of the Draft Procedures and Guidelines.

Where appropriate the AER intends to combine performance and compliance audits in relation to customer hardship policies, ensuring that any reporting or publication of results clearly distinguishes between measures of compliance and performance.

6 Enquiries and investigations

Where the AER has identified breaches or possible breaches of the Customer Framework, or where breaches have been reported to the AER by regulated entities or other parties, we will initiate a process of enquiry and/or investigation to determine the nature and extent of any breach that has occurred.

The issues paper explained that when investigating a potential breach the AER may seek information from regulated entities, retail marketers, customers and other parties. We would prefer to collect this information on a voluntary basis, and in making preliminary enquiries will generally endeavour to do so. However, the Retail Law does allow the AER to obtain search warrants[10] and to compel the production of information and documents that are relevant to its investigation.[11] We noted that these powers can and will be used when required.

In the interests of openness and transparency, we proposed to publish the outcomes of investigations in compliance reports and bulletins, including details of relevant incidents, the main findings, and any recommendations (e.g. for further review or rule changes). This approach was put forward as a means to increase awareness of rights and obligations under the Customer Framework and improve compliance practice.

6.1 Discussion of submissions

Stakeholders raised a number of specific issues in relation to the nature of information to be published and the means by which the results of an investigation are communicated to the market and the public more generally.

EWON considered AER investigations to be a matter of public interest, and that all stakeholders should be made aware of them. It supported the use of email alerts and publication of investigation results on the AER's website. Both CUAC and CALC supported the AER publishing investigation results in its annual compliance reports. CALC also recommended the AER use media releases to publicise significant breaches of the Customer Framework. By way of example, it suggested that additional publicity would be required where an investigation confirmed that a breach of the Retail Law or Rules had occurred and led to enforcement action such as the acceptance of an enforceable undertaking or litigation.

Regulated entities were more reserved in their support for the AER's proposed approach. Origin Energy's submission focused on the risk of unnecessary and unconstructive media attention where public 'naming and shaming' was used as part of communicating investigation results. It suggested that any public commentary be limited to the facts and the law to ensure accuracy and balance. TRUenergy argued that there was limited benefit in publishing the results of all investigations. TRUenergy further suggested that the AER should only communicate the outcomes of investigations where there is a demonstrable breach of the Customer Framework. Releasing information on these investigations would inform regulated entities on good compliance practice and act as an incentive to comply.

[10] s. 309 National Energy Retail Law.
[11] s. 206, National Energy Retail Law.

TRUenergy, AGL, Powercor and Citipower all expressed concern that publication of the details of an investigation may divulge commercially sensitive or confidential information. UED Multinet and AGL proposed that the AER give the regulated entity concerned the opportunity to review an investigation report for errors of fact prior to publication. In addition, AGL submitted that retailers should have an opportunity to rectify any breach identified through an investigation before an investigation report is published.

We recognise the importance of accuracy and objectivity in reporting publicly on enquiries and investigations. These activities may relate to matters of public interest, and have the potential to attract media attention and commentary. The way in which we publish information on completed investigations, and the information actually published, are likely to vary depending on the nature and progress of the investigation.

The AER may choose to report on completed investigations where it is useful to highlight compliance issues to interested customers, regulated entities and other stakeholders. Reports on completed investigations may include an explanation of:

- the circumstances giving rise to the investigation
- the AER's investigative process, including the reasons for its conclusions as to the existence (or not) of a breach of the Retail Law or Rules
- where a breach is identified, the AER's decision on the appropriate course of action.

In presenting the outcomes of an investigation, we may also include any steps that we know have been taken by the relevant regulated entity or entities to rectify the breach at the time of the report (including any steps to be taken under voluntary or enforceable undertakings).

Where an investigation has been concluded it is possible that the AER may choose to pursue an enforcement action (whether administrative or statutory) in order to rectify any breach. Given the time it can take to fully rectify a breach, and the public interest in the process of rectification, it will not always be appropriate to withhold the results of an investigation until a breach has been fully rectified. Where enforcement action has commenced or a breach has not been fully rectified at the time an investigation report is published, our investigation report may also include details of the expected timeframe for its completion.

As a matter of practice, we will generally require any claims that information is confidential to be made to the AER at the time that information is provided to us. Where a report on an investigation may contain information that has been accepted by us in confidence, we will generally give the relevant regulated entity a brief opportunity to review the report. This will provide an opportunity to identify any information that the regulated entity maintains should not be disclosed. Details of the AER's approach to information management, including the treatment of confidential

information, are available in the *ACCC–AER information policy: the collection, use and disclosure of information* on our web site.[12]

6.2 Summary of position

Where a possible breach of the Customer Framework is identified, the AER will make further enquiries and investigate to determine whether a breach has occurred, and the nature and extent of any such breach. Our preferred approach to investigations is to make preliminary enquires to the relevant regulated entity or entities on a voluntary and cooperative basis. However, where necessary the Retail Law gives us broad-reaching powers to obtain the information we require. It also allows us to compel the production of information and documents by any person. The AER may choose to report on completed investigations where it is useful to highlight compliance issues to interested customers, regulated entities and other stakeholders.

Our proposed approach to enquiries and investigations is set out in section 5 of the Draft Statement of Approach.

[12] http://www.aer.gov.au/content/index.phtml?itemId=656023

7 Enforcement

When a breach of the Retail Law or Rules is identified through the investigative process, the AER will take action to enforce compliance.

The issues paper explained that our objectives in enforcement are to resolve matters efficiently and in a timely manner, to address breaches of the Customer Framework and prevent reoccurrence, and to minimise and where possible rectify any damage to customers, other regulated entities and the market. In pursuing these objectives we also noted the value of clarifying the application of the Retail Law, Regulations and the Rules and encouraging the effective use of compliance policies, systems and procedures by regulated entities.

The issues paper also set out the range of administrative and statutory enforcement options that are available to the AER under the Retail Law. We confirmed that our enforcement response to each breach would be determined on a case-by-case basis. This will ensure that our response is proportionate to the impact and circumstances of the breach, the compliance history and established compliance systems, policies and procedures of the regulated entity, and the cooperation of the regulated entity with the AER.

7.1 Discussion of submissions

Submissions received on enforcement were broadly supportive of the approach presented in the issues paper. However, many argued for greater clarity as to the AER's objectives, priorities and decision making criteria. They also sought clarification of the role these may play in determining the nature and extent of our enforcement activity under the Customer Framework.

Strategies for enforcement

In general, consumer groups, regulated entities and ombudsman schemes all broadly supported the objectives and priorities for enforcement set out in the issues paper. CALC sought reinforcement of the importance of consumer protection among these objectives, and recommended that the AER include the objective of undoing the harm caused by the contravening conduct.

Similar reinforcement was sought in relation to the proposed enforcement priorities. While CALC noted its broad support for the priorities listed, it expressed concern that the proposed priorities would set too high a bar for the initiation of an enforcement response. CALC proposed a series of amendments to the enforcement priorities to address this issue, including a proposal that the AER prioritise enforcement activity that would clarify the operation of the law. It also proposed clarification of the AER's proposed consideration of conduct demonstrating blatant disregard for the Customer Framework to explicitly include blatant, ongoing or serious disregard for the Customer Framework. CALC also suggested amending the consideration of conduct that is industry wide—so that enforcement action is likely to have a widespread educative or deterrent effect—to include conduct that is simply widespread.

Regulated entities also expressed concern that the AER's enforcement priorities were vague and poorly defined. Clarification of the proposal to prioritise conduct that is of significant public interest or concern was of key interest. UED Multinet warned

against the danger that enforcement priorities could become based on perception and the 'loudest voices of the day'. There was some suggestion that AER should relate its enforcement priorities to the three tiered approach to compliance reporting obligations applied to selected obligations under the Customer Framework (discussed in part 4 of this draft decision).

Our intent in developing a strategic approach to enforcement is twofold:

- Enforcement is a tool available to the AER in its work to build appropriate levels of compliance in the retail market. By identifying what we hope to achieve through use of our enforcement tools, we aim to identify the role that they may play in ensuring effective compliance with, and operation of, the Customer Framework.

- Our role in building compliance in the retail market is a sizeable task. Breaches of the Customer Framework could conceivably take place at any time, and the range of scenarios in which breaches of the Retail Law and Rules may arise is limitless. In this environment we will need to plan enforcement work strategically to ensure that we give appropriate attention to resolution of those matters of greatest concern to stakeholders, and that there is a structure within which our 'triage' process can begin.

Our Draft Statement of Approach broadly identifies the range of enforcement options available to the AER. The Draft Statement of Approach also outlines matters that may inform our consideration of how enforcement can be used as a tool to address breaches when they are identified. In this way the AER retains flexibility to evaluate the particular circumstances in which a breach occurs, and to apply the appropriate enforcement tools and options on a case by case basis.

The considerations proposed in section 6 of the Draft Statement of Approach have been refined in response to the suggestions made and concerns raised in stakeholder submissions.

Enforcement tools

Submissions were generally supportive of the approach to selection of the appropriate enforcement tool for a particular matter in the issues paper. Stakeholders proposed a series of refinements, including some additional factors that might usefully inform the AER's decision on which of the enforcement mechanisms available is appropriate in each case.

EWON suggested that the proposed consideration of a regulated entity's cooperation with the AER in the investigation of the breach be extended to include recognition of the level of cooperation with the relevant ombudsman scheme in resolving any related customer disputes. CUAC proposed consideration of the extent to which the relevant regulated entity gained financially from the breach. CALC suggested the assessment process more directly reflect the AER's intent to ensure that the enforcement response was proportionate to impact of the breach. It sought clearer recognition of:

- the effect of the breach on customers and the nature of the detriment caused, whether that detriment was likely to be ongoing, and customers' ability to obtain relief without intervention by the AER

- the number of customers currently affected or likely to be affected, and whether the conduct affected disadvantaged or vulnerable customer groups

- conduct reflecting a significant or emerging market issue, or which is industry wide or likely to become widespread if the AER does not intervene

- conduct that is of significant public interest or concern.

CALC also recommended consideration of the likelihood that a particular approach to enforcement would have a worthwhile educative or deterrent effect.

Citipower and Powercor sought confirmation that the AER would have regard to any mitigating work undertaken by the regulated entity to minimise the impact of the breach. Other factors such as force majeure events and inconsistent obligations in the Customer Framework that may make compliance with obligations difficult to manage were also considered relevant. They went on to suggest that the cost of fully complying with an obligation and the degree of the breach should be taken into account.

Stakeholders generally supported the availability of a range of enforcement options and a process of escalation that is reflective of the significance or materiality of the breach and the conduct of a regulated entity in the course of an investigation and over time. A flexible approach that allowed the AER to make the best decision in a particular circumstance was widely considered to be appropriate.

Regulated entities reiterated their preference for administrative approaches designed to resolve compliance issues quickly. They felt strongly that other options should be reserved for exceptional or extreme cases. Some considered administrative action to be appropriate in all situations and recommended that the AER approach to enforcement in any case should always start with the least invasive measure. Statutory enforcement options—including enforceable undertakings, infringement notices and litigation—were seen as last resorts. It was suggested that they only be used in response to serious and flagrant breaches with industry wide ramifications or where breach is systemic. There was general recognition that escalation to statutory enforcement measures was appropriate in certain circumstances, in particular where the use of administrative options had been unsuccessful. Many regulated entities acknowledged the AER's statutory enforcement powers. However, a number argued that the threat of escalated enforcement action would create sufficient incentives for regulated entities to avoid it, so that use of these powers would be unnecessary.

Consumer groups recognised the value that administrative enforcement solutions can offer, but expressed reservations about their use in certain circumstances. CALC was concerned that administrative enforcement action would not be able to achieve redress for customers, and noted that administrative options described in the issues paper would not set a legal precedent. It recommended that there should be an educational focus included in any administrative action. CUAC submitted that an administrative response was appropriate only where the AER's investigations reveal the potential

risk from the breach to be low. CUAC emphasised the importance of seeking assurances from regulated entities when attempting to use administrative action. Such assurances would set out how and when compliance is to be expected and what reporting arrangements would be adopted until compliance is achieved. Where a regulated entity did not provide such assurance, or failed to comply, CUAC considered that escalated enforcement action would be appropriate. As noted above, this was a view shared by the regulated entities.

As our issues paper explained, the AER will have a number of enforcement options in the event that our investigations give us reason to believe that a breach of the Customer Framework has occurred. Some of these—infringement notices, enforceable undertakings, orders and penalties available through litigation, and in extreme cases revocation of a retailer's authorisation—are provided by the Retail Law. The nature of these enforcement options and in particular the amount of any penalty payable and the type of orders than can be sought from a court, is defined by the Customer Framework. Other options, which we have loosely defined as administrative in nature, are of our own making and are limited only by the willingness of regulated entities to cooperate with the AER when a breach is identified to ensure that it is addressed. An administrative enforcement solution can take whatever form is appropriate in the circumstances to achieve compliance. This may include commitments to change behaviours and to provide redress to affected customers. They provide a flexible means to remedy a breach of the Retail Law or Rules, but as submissions have noted can not be enforced. This emphasises the importance of recording any assurance provided by a regulated entity as part of an administrative arrangement.

We must emphasise that the decision on the appropriate enforcement response is one that has to be made on a case-by-case basis, with regard to all the relevant circumstances. Subject to limitations in the Retail Law (for example, in identifying a subset of obligations as civil penalty provisions to the exclusion of others), no enforcement option can be ruled out prior to reviewing each case on its merits. Nor will we commit to taking a particular course of action in response to a pre-defined category of breaches. However, this range of enforcement options provides the AER with considerable scope to arrive at an enforcement decision that is proportionate to the breach it seeks to address. This will contribute to the achievement of compliance and deterrence in the retail energy market. It allows discretion to pursue stricter and more intrusive penalties for serious breaches and cooperative solutions for those which have a less significant impact on customers and the market. It also allows for a process of escalation where regulated entities are not responsive and/or demonstrate continued failure to comply after initial action is taken. The Draft Statement of Approach published with this draft decision provides examples of matters to which the AER may have regard in deciding what enforcement response is appropriate in a particular situation. These examples have been refined in response to stakeholder submissions on this issue.

The Draft Statement of Approach also provides examples of how the AER may be able to work with regulated entities to settle and record administrative enforcement arrangements or accept enforceable undertakings under the Retail Law. Our approach to accepting enforceable undertakings is likely to be informed by the experience of the ACCC and ASIC in the application of similar powers under section 87B of the

Trade Practices Act 1974 (Cth) and sections 93A and 93AA of the *Australian Securities and Investment Commission Act 2001* (Cth). If, over time, it becomes apparent that enforceable undertakings are best used in a particular way to achieve results in the energy retail market, we may consult on the development of formal guidance on the AER's acceptance of enforceable undertakings for inclusion in the Draft Procedures and Guidelines.

In their combined submission on how the appropriate enforcement response to a breach should be determined, Citipower and Powercor suggested that in certain circumstances rule changes may be a more appropriate response than enforcement action.

The AER will not have a role in determining energy policy, or in the determination of the regulatory obligations that will apply to energy retailers and distributors in their relationships with customers and other regulated entities. Energy policy will be determined by the MCE. The MCE has developed the initial Retail Law and Rules. On commencement of the Customer Framework, the Australian Energy Market Commission (AEMC) will become the custodian of the Retail Rules, and will be responsible for the assessment (but not the initiation) of proposed rule changes. The role of the AER is to implement and ensure compliance with the Customer Framework as drafted. It is not the AER's role to determine whether an obligation that has been breached should be recast rather than enforced—we must consider compliance with the Customer Framework as it is in force from time to time. It will, however, be open to the AER to submit a rule change proposal to the AEMC, for example, where it considers that a rule is ineffective or inconsistent with other rules. However, the AER can not ignore a breach of the Retail Law or Rules on the basis that a requirement is considered by stakeholders to be inappropriate or impractical.

7.2 Summary of position

Where the AER investigative process identifies a breach of the Customer Framework, the AER will take enforcement action. When applying the enforcement options available under the Retail Law, the AER will have regard to building compliance with the Customer Framework for the benefit of customers by:

- stopping the breach and the behaviour that constituted the breach
- correcting the damage that the breach has caused
- preventing and the same behaviour from reoccurring, and deterring other regulated entities from repeating it
- clarifying the operation of the Retail Law and Regulations.

The Draft Statement of Approach published with this draft decision sets out the AER's proposed approach to enforcement decisions under the Customer Framework. This proposed approach has been refined on the basis of the submissions discussed in the sections above to include consideration of:

- the circumstances in which the breach took place

- the period over which the breach extended
- whether the breach was deliberate or avoidable if reasonable compliance practices had been followed
- whether the breach arose out of the conduct of senior management or lower level staff
- whether the regulated entity gained financially from the breach, and if so the amount of the financial gain
- the impact of the breach, and the damage or detriment suffered by customers or third parties, which may include consideration of:
    - the number of customers affected or likely to be affected, and whether the conduct affected disadvantaged or vulnerable customers,
    - the nature of the impact on the affected customers (for example, physical harm to customers, a substantial detriment to quality of life, or widespread significant financial harm),
    - whether that impact is likely to be ongoing, and
    - the ability of affected customers to obtain relief without intervention by the AER.

Enforcement responses may also be informed by the regulated entity's own actions in relation to a breach including:

- the level of cooperation with the AER (and where applicable the relevant ombudsman scheme), and in particular whether the regulated entity itself identified the breach and approached the AER voluntarily
- action taken or planned by the regulated entity to rectify the breach and avoid a reoccurrence.
- whether the regulated entity has a corporate history of compliance, as evidenced, for example, by the effectiveness of its compliance policies, systems and procedures
- any previous unsuccessful attempts to resolve past breaches through administrative enforcement options.

While we will make our enforcement decisions on a case by case basis with regard to the full range of enforcement options available to us, statutory enforcement action and in particular civil proceedings, are most likely in circumstances where the breach:

- has resulted, or is likely to result, in significant customer detriment, particularly where that conduct affects disadvantaged or vulnerable customer groups,
- demonstrates blatant, ongoing or serious disregard for the Customer Framework,

- is widespread, so that enforcement action is likely to have a widespread educative or deterrent effect,
- is that of a person, business or sector that has a history of previous breaches of the energy laws,
- is of significant public interest or concern, or
- involves new or emerging market issues.

Our approach to enforcement of the Customer Framework is set out in section 6 of the Draft Statement of Approach.

8 AER compliance reports

In our issues paper we proposed to publish quarterly compliance reports throughout the year, providing information on the AER's monitoring activities and the extent to which regulated entities have complied with their obligations under the Retail Law and Rules. From time to time, compliance reports may also comment on investigations and enforcement action taken by the AER. A consolidated annual compliance report would be released at the end of each financial year.

8.1 Discussion of submissions

Submissions received in relation to this issue primarily noted how each of the stakeholders utilised compliance reports published by the AER. The main issue of contention was the frequency of such reports.

Consumer groups supported the AER's proposal of quarterly reports. CALC stressed the need for the AER to provide an update on compliance activity, including specific enforcement action, details of incidents and retailer redress. It recommended the use of media releases to inform interested parties of these activities, suggesting that such action would reduce the requirement for the AER to audit regulated entities. EWON and Origin also supported the proposal to publish quarterly compliance reports. They noted that these reports allow regulated entities and other stakeholders to stay informed of compliance issues impacting the industry.

Other regulated entities, including UED Multinet, Citipower, Powercor and AGL, all suggested that annual compliance reporting was sufficient, and that more frequent reports were likely to be quite repetitive, providing limited benefit to the industry. Six-monthly reporting was suggested as an alternative if the AER wished to report more often than annually. PIAC supported this view, noting that an annual reporting cycle allows for the identification of trends in the industry over time.

The AER is reluctant to restrict itself to a single annual report for each financial year. We see benefit in providing information on compliance issues and signalling areas of focus in the AER's compliance monitoring activities through more frequent reporting. However, we have amended our position and now propose to publish quarterly bulletins, detailing the AER's compliance activities. These quarterly bulletins will be supplemented every six-months with an additional attachment providing further specific details on significant compliance issues and key developments for that half-year. In addition to these four reports, each year we will publish an annual review of compliance in the market. Supplementary targeted bulletins or media releases may also be issued to coincide with significant market events

We will consider the adequacy of this revised approach over time, and should it become apparent that more frequent reporting is appropriate we will revise our approach.

8.2 Summary of position

The Draft Statement of Approach published with this draft decision confirms the AER's current intention to publish an annual compliance report for each financial year. These reports will provide information on our monitoring activities and on regulated entities' compliance with the Customer Framework. We may also publish

additional information throughout the year in the form of quarterly updates and a mid-year report providing information on significant compliance issues and developments. The AER may also produce compliance bulletins and media releases issues to coincide with significant market developments.

The AER's proposed approach to the publication of compliance reports is set out in section 6 of the Draft Statement of Approach.

Our objective in publishing these reports and updates is to provide the market with timely, constructive and informative reports on compliance with the Customer Framework. The information presented in the reports will encourage compliance with the Retail Law and Rules by educating and informing both regulated entities and customers about their rights and responsibilities.

9 Compliance policies, systems and procedures for regulated entities

The Retail Law requires regulated entities to establish policies, systems and procedures to enable the regulated entity to efficiently and effectively monitor compliance with the requirements of the Customer Framework. The issues paper proposed a requirement that regulated entities establish and observe compliance policies, systems and procedures in a manner consistent with the Australian Standard on Compliance Programs (AS 3806), as amended from time to time. Our proposal was founded in the opinion that the standard provided for a holistic, whole-of-business approach to compliance incorporating provision for review and assessment over time. This allows flexibility for each regulated entity to develop policies, systems and procedures to suit their operating environment.

9.1 Discussion of submissions

Several submissions expressed concern that the AER was proposing to provide or dictate a compliance system. ActewAGL, AGL, Origin and TRUenergy emphasised the benefits of regulated entities developing their own compliance systems and having the flexibility to adapt internal compliance systems to suit their needs. However, the majority of regulated entities considered AS 3806 to be an appropriate model for any guidance to be provided by the AER. CUAC and CALC also supported the use of AS 3806 as the model for compliance systems.

CUAC argued regulated entities could use AS 3806 to demonstrate they have a commitment to compliance by implementing this standard, and that they could report on whether they have implemented AS 3806 in their annual compliance reports.

The AER does not intend to use its Draft Procedures and Guidelines to establish a template compliance system for regulated entities. We agree that there is benefit in allowing each regulated entity to develop its own systems, and to adapt them to their needs over time. Each retailer and distributor will be accountable for its own compliance with the Customer Framework. The responsibility for the development of appropriate internal compliance policies, systems and procedures rests squarely with them. That said, in working to build a compliant energy retail market the AER sees value in regulated entities adopting the governing principles established in the standard and in making clear its expectation that they do so. This will provide a clear benchmark against which the adequacy of internal compliance policies, systems and procedures can be measured. Our proposal to require establishment and observation of compliance systems, policies and procedures in a manner consistent with AS 3806 recognises the flexibility that the standard affords to regulated entities and the importance of providing such an independent benchmark. The Retail Law requires consideration of whether a regulated entity has established and complied with the policies, systems and procedures developed under section 273 in accordance with the Procedures and Guidelines, providing further support for our preference to establish a consistent benchmark.

The dynamic nature of the standard provides a reference point for regulated entities that will continue to evolve in accordance with best practice, reducing the risk that any model presented in the Procedures and Guidelines (and any program adopted by a

regulated entity in keeping with those Procedures and Guidelines) will become outdated over time.

9.2 Summary of position

The Retail Law requires regulated entities to establish and observe policies, systems and procedures to enable them to efficiently and effectively monitor their own compliance with the requirements of the Customer Framework, and to do so in accordance with the relevant provisions of the Procedures and Guidelines. Clause 2 of the Draft Procedures and Guidelines requires these compliance policies, systems and procedures to be established and observed in a manner consistent with the Australian Standard on Compliance Systems (AS 3806), as in force from time to time.

A. List of Submissions

Submissions were received from the following parties:

ActewAGL Distribution (ActewAGL)

AGL Energy Ltd (AGL)

Australian Power & Gas Pty Ltd (APG)

Consumer Action Law Centre (CALC)

Consumer Utilities Advocacy Centre (CUAC)

CitiPower Pty (Citipower)

Energy Retailers Association of Australia Limited (ERAA)

Energy & Water Ombudsman NSW (EWON)

Public Interest Advocacy Centre Ltd (PIAC)

Queensland Council of Social Service inc (QCOSS)

Origin Energy Retail Limited (Origin)

Jemena Electricity Networks (Vic) Ltd (Jemena)

United Energy Distribution and Multinet (UED Multinet)

Powercor Australia Ltd (Powercor)

TRUenergy Pty Ltd (TRUenergy)

LUMO Energy (Lumo)