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Mr Tom Leuner
General Manager
Markets Branch
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

By email: AERInquiry@aer.gov.au
Dear Mr Leuner

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

AGL Energy Ltd (**AGL**) welcomes the opportunity to provide comments on the *Issues Paper: Approach to compliance with the National Energy Retail Law, Rules and Regulations* (the **Issues Paper**) published by the Australian Energy Regulator (the **AER**) on 31 April 2010.

AGL takes its compliance obligations seriously, and understands the potential negative impacts of regulatory breaches, both from a customer and a business perspective. As such, extensive resources are utilised within AGL to facilitate and monitor compliance.

AGL will work co-operatively with the AER to support its compliance monitoring and reporting functions. Accordingly, AGL encourages the AER to take a similarly co-operative approach and to intervene only when necessary and appropriate.

A matter not specifically addressed in the Issues Paper is the approach the AER intends to take to compliance during the introduction of the National Energy Customer Framework (**NECF**). It is currently unclear as to how each of the jurisdictions proposes to transition to the NECF, and this will undoubtedly lead to a period of some confusion in the industry. Potentially, this could cause an increase in regulatory breaches and AGL would expect the AER to allow for this in terms of its approach to investigation and enforcement. New reporting requirements will also necessitate system changes, which will take time to implement. Clear guidance from the AER on how it proposes to deal with these transitional issues within its compliance function would be of benefit to the industry.

Our responses to the specific questions for consideration contained in the Issues Paper are provided at Attachment A.

Should you wish to discuss any aspect of this submission further please contact Anna Stewart, Manager Regulatory Policy and Strategy on 03 8633 6830.

Yours sincerely,

Alex Cruickshank
Head Energy Regulation

Attachment A

1. Proposed approach to compliance under the Retail Law

There is a sense when reading this first section of the Issues Paper that the AER is approaching compliance monitoring almost as if it is a new concept for energy retailers. However, energy retailers have for some time been subject to strictly enforced, and at times, onerous compliance schemes administered by the jurisdictional regulators. Energy retailers are generally well aware of their regulatory obligations and the importance of ensuring a robust culture of compliance within their organisations. Most, if not all, retailers already have policies, systems and procedures in place to facilitate regulatory compliance, and this should be taken into consideration by the AER in shaping its Compliance Procedures and Guidelines.

AGL recognises that there may be times when the AER will be required to take 'vigorous enforcement action'. However, we hope that this would be a last resort and that the AER will approach any non-compliance by first affording the retailer the opportunity to explain the issue and undertake their own thorough investigation. It is essential that there be mutual co-operation between the AER and retailers, and that both parties endeavour to develop open and transparent relationships. Retailers should be encouraged to discuss potential non-compliances with the AER, without fear that the AER will straight away launch into an intrusive investigation. It is AGL's experience that where retailer/regulator relationships are effective, that non-compliances can be dealt with practically and with a view to minimising customer impacts and unnecessary business costs.

With respect to strategies for communicating with retailers about compliance, AGL considers that there is no single strategy which will be of most use – it will depend on the issue as to what form of communication is the most effective. Any new compliance requirements are perhaps initially best dealt with through public forums and targeted presentations in which the AER can provide guidance. In comparison, ad hoc compliance issues which may arise are most effectively dealt with through one-to-one discussions with the entity in question. If an issue appears to be industry wide then a publication may be the most effective form of communication.

In relation to publications, AGL queries the efficacy of quarterly reports. Not only would this be a time consuming undertaking for the AER, but it may also present an inaccurate picture of the state of compliance in the market. For example, a report may note that an issue is being investigated by the AER. However, it may be too early in the investigation to understand the full impacts of the issue. There is arguably little point in reporting something unless the issue has been fully investigated and analysed. Perhaps six-monthly or annual reports would be more effective and present a more accurate picture of the state of the market.

Any publications the AER puts out, whether they are reports or compliance bulletins, need to be accurate, concise and targeted to the needs of the audience in order maximise their effectiveness. While guidance on the AER's view of a particular regulation will be useful to retailers, it is important to note that ultimately it is for the courts to interpret the law.

2. Monitoring compliance

Factors to be considered in assessing the impacts and likelihood of a breach

AGL supports, in principle, the AER's approach towards assessing the impact of a breach. It makes sense that the AER will intensively monitor those breaches which stand to have the greatest impact on the achievement of the national energy retail objectives. Such

monitoring should, however, not be invasive until there is clear evidence of systemic and sustained non-compliance by a retailer. It is also important, as the AER has noted, that the complexity of the obligation and the actions needed to manage it, are critical considerations when determining the likelihood of a breach.

AGL is concerned by the statement on page 15 of the Issues Paper that 'regulated entities are less likely to breach a provision of the Retail Law or Rules where the breach will be visible, and the repercussions damaging.' The inference from this statement is that breaches of regulatory obligations are intentional. It fails to take into consideration the fact that retailers take their regulatory obligations seriously and have a starting position of compliance, as opposed to non-compliance. Potential enforcement action is obviously a serious deterrent, but so too is reputational risk. Retailers fully understand the costs of non-compliance in relation to their customers – a satisfied customer costs far less to serve than one who is dissatisfied and lodges a complaint with the retailer, the Ombudsman and/or the media. It is highly unlikely therefore that a retailer would deliberately set out to breach an obligation.

AGL is also concerned with the AER's intention to consider past compliance performance. While there is no doubt that compliance reports previously published by jurisdictional regulators may provide an insight into a retailer's compliance culture, it should be remembered that these reports represent a snapshot in time and, as such, must be considered in context. The AER should avoid drawing conclusions based on the past because there may have been underlying reasons for a retailer having a poor year in terms of compliance. For example, in 2007 AGL undertook a major upgrade of its customer billing system. Despite an enormous amount of planning and expense, there were nevertheless compliance issues which arose in the transfer of customers to the new system. While AGL is not excusing the fact that there were negative customer experiences as a consequence of the system upgrade, the level of non-compliances during this period should not be used at a time in the future to suggest that AGL is likely to breach certain regulatory obligations.

AGL disagrees with the AER's view on page 17 of the Issues Paper that 'the operation of the energy retail market is less transparent than in wholesale energy markets'. On the contrary, we consider that the retail energy market is actually more transparent in certain respects. The media is often keen to report on any potential customer issues in the retail market, as are the jurisdictional Ombudsman schemes. It would be virtually impossible for a retailer to hide a non-compliance which has any widespread customer impacts. Even a 'one-off' breach may attract media coverage depending on the customer impact. Consumer advocates are also quick to raise any issues which may arise through their casework. As such, there is a high degree of public scrutiny in relation to energy retailers which translates to a fairly high level of transparency. This is not necessarily the case with the wholesale market.

Market intelligence and information

In terms of the sources of information the AER proposes to use in order to gather intelligence on the state of compliance within the market, AGL would caution against too much reliance on energy Ombudsman scheme reports and the AER's Consumer Consultative Group (**CCG**).

The raw data contained in Ombudsman reports does not provide the full picture and complaint numbers are at best only indicative of a retailer's level of compliance. The Ombudsman schemes only report on complaint numbers, and generally, complaint causes and outcomes are not explained in detail. A complaint may not have arisen as the result of an actual regulatory breach and a retailer may have chosen to settle a complaint purely on the basis of a cost-benefit analysis, regardless of whether there has been an actual breach.

With respect to the AER's use of market information provided through its CCG, it should be recognised that the majority of the members of this group generally represent a small section of the market, namely low-income and vulnerable consumers. Furthermore, the information provided is often anecdotal and should not be relied on without first speaking with the retailer in question.

This leads to the final point in relation to this issue – that the AER should not underestimate the willingness of retailers themselves to provide information on potential incidents and areas of non-compliance. AGL would rather be on the 'front foot' with the AER about a potential issue, than have the AER find out about it through the media or Ombudsman scheme.

Targeted compliance reviews

AGL is opposed to the concept of targeted compliance reviews unless there is market failure to warrant them. Such reviews, particularly if undertaken quarterly, would be onerous when considered in the context of all of the other reporting obligations retailers will have. There is no reason why compliance with changes in the regulatory framework and the introduction of new obligations cannot be measured through compliance and performance reports and audits.

Retailer and distributor reporting

The AER should not underestimate the resources required to maintain compliance reporting. Overly frequent reporting is not only intrusive but costly and will take the focus away from actually ensuring compliance, as opposed to reporting on it.

AGL considers that a tiered structure of reporting is generally appropriate. However, we raise the following points for consideration.

The Issues Paper on page 21 refers to a breach which has a 'significant impact on a large number of customers' having to be reported immediately. AGL sees two issues with this. Firstly, what is a large number of customers for one retailer may be an insignificant number for another. The proportion of a retailer's customer base should therefore be considered. Secondly, it is not always possible for immediate reporting on the event of a breach as it may not be immediately evident that a breach has occurred. Obviously, the potential for a breach to impact public health or safety is something a retailer would take extremely seriously and as such, would report as early as possible. Very few breaches would fall into this category however, and AGL submits that reporting within 24 hours would be more realistic and allow at least a preliminary investigation to be undertaken.

It is often only once a breach has been fully investigated that its impact can be accurately measured. Accordingly, AGL suggests that the AER consider the introduction of an 'early warning' option into the system. For example, if a retailer suspects it may have breached an obligation, but it is yet to understand fully the number of customers impacted and the consequent implications, it could give the AER 'a heads up' that there may be an issue. Once an initial investigation has been undertaken, the retailer could then formally report to the AER if a breach has in fact occurred.

Quarterly reporting is considered to be too onerous, not only for retailers, but also the AER. Reporting of this frequency would effectively lead to a system of constant reporting, and would not necessarily lead to greater compliance. Reports can only ever be a lagging indicator of compliance levels, so are therefore not the most efficient or effective method of the AER determining the state of a retailer's compliance. Furthermore, quarterly reports may not provide enough time for a retailer to fully investigate a breach and may therefore not provide the accurate information. AGL has had situations whereby an initial investigation of a breach suggests a certain number of customers have been impacted, but

once a full systems review has been undertaken, significantly less or more customers have in fact been impacted.

Accordingly, AGL considers that unless a breach is so serious as to threaten public health or safety, that annual compliance reporting is appropriate. While this creates a two-tiered structure, the introduction of an 'early warning' system, particularly where an initial investigation may suggest a systemic issue, could effectively be seen as the third tier.

Compliance audits

It is imperative that the AER considers business impacts and costs when determining when an audit should take place. The scope of the audit should be targeted and clearly defined, in consultation with the retailer. In determining whether an audit should be conducted by or on behalf of the AER, or by the retailer, cost effectiveness must be paramount. If the audit is being conducted by or on behalf of the AER, the retailer has little input if any, into costs. Rather than having standard payment arrangements set out in the AER Compliance Procedures and Guidelines, AGL would prefer such matters to be determined on a case-by-case basis. In situations where the scope of a single audit covers more than one retailer or distributor, the costs of the audit must be entity specific and allocated accordingly.

Interaction of compliance and performance audits on hardship policies

AGL has advised the AER in a previous submission of its concerns with respect to the proposed approach to the development of national hardship indicators. We will not repeat these concerns here.

Suffice to say that AGL is not opposed to the proposal whereby compliance and performance reports in relation to retailer's hardship policies will be combined. We agree that such an approach is likely to be more efficient and provide a more complete picture of the retailer's performance in this area – to the extent that such reporting can ever really reflect the true impact of a hardship program, given all of the other factors involved in customer hardship.

3. Principles for investigations and enforcement

AGL considers that the AER will be able to carry out the majority of its investigations with retailers on a co-operative basis, without the need to resort to search warrants and other powers in order to compel the production of documents. Retailers should always be provided with the opportunity to voluntarily provide relevant information to the AER.

While AGL does not oppose the publication of the AER's investigations, we do expect that investigations will only be made public once all of the facts are known and verified, and the retailer has had the opportunity to rectify the breach. Any confidential information regarding a retailer's business should remain confidential.

AGL does not propose to comment on the enforcement powers likely to be available to the AER under the Retail Law and under what circumstances it would be appropriate to use those powers. Clearly, this is something that would need to be determined on a case-by-case basis, taking into consideration all of the relevant circumstances. It is expected that the AER will use its enforcement powers judiciously and always as a last resort, failing the co-operation of the retailer in question. Furthermore, the enforcement action taken should always be commensurate with the impact and seriousness of the regulatory breach, and the underlying cause of the breach.

4. Compliance policies, systems and procedures for regulated businesses

Retailers should be able to determine for themselves the most effective systems and procedures to have in place to facilitate compliance with their regulatory obligations,

including reporting obligations. Having said this, AGL supports, in principle, the use of the Australian Standard on Compliance Programs (AS 3806) as an appropriate model for compliance policies, systems and procedures. Whether it continues to be the most appropriate model should be reviewed at least every few years to ensure relevance and benefits, recognising, however, that changes to retailer's systems can be costly and time-consuming.