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By email: AERInquiry@aer.gov.au

Mr Tom Leuner
General Manager, Markets Branch
Australian Energy Regulator
PO Box 520
MELBOURNE VIC 3001

Jemena Limited
ABN 95 052 167 405

321 Ferntree Gully Road
Mount Waverley VIC 3149
Locked Bag 7000
Mount Waverley VIC 3149
T +61 3 8544 9000
F +61 3 8544 9888
www.jemena.com.au

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

Dear Mr Leuner

Jemena appreciates the opportunity to comment on the notice of draft instrument, draft statement of approach and draft procedures and guidelines dealing with the AER's proposed approach to compliance and enforcement under National Energy Customer Framework (**NECF**). These documents were issued in March 2011. Jemena has participated in the AER's previous two consultations on this matter.

Jemena's response to the AER's request for comments is set out in **Attachment 1**.

Jemena welcomes the positive improvements that have been made to the draft procedures and guidelines. But Jemena is concerned that the AER's responses to the January 2011 consultation – contained in the notice of draft instrument – do not reflect a realistic view of likely business readiness for the NECF by 1 July 2012.

Jemena looks forward to further progress in resolving compliance and enforcement issues raised by the NECF. If you wish to discuss the submission please contact Paul Johnston on (02) 9455 1560 or at paul.johnston@jemena.com.au.

Yours sincerely

A handwritten signature in black ink that reads "Sandra Gamble".

Sandra Gamble
General Manager Regulation and Strategy
Jemena Limited

Attachment:

1. Jemena, *Response to AER consultation — Draft AER Compliance Procedures and Guidelines - National Energy Retail Law, Retail Rules and Retail Regulations*, 6 May 2011

ATTACHMENT 1

Draft AER Compliance Procedures and Guidelines —National Energy Retail Law, Retail Rules and Retail Regulations

6 May 2011

1. Introduction and key messages

The documents issued by the AER deal individually with the aspects of compliance and enforcement for which the AER will be responsible whenever the National Energy Customer Framework (**NECF**) is implemented in each jurisdiction.

Our submission addresses the AER proposals broadly across the draft statement of approach, notice of draft instrument and draft procedures and guidelines. We have particularly focused on the notice of draft instrument, which establishes some broad AER positions on compliance generally, as well as responding to issues raised in submissions to the January 2011 consultation.

Jemena's key messages are:

Business readiness and transition

Jemena considers that the AER's implicit assumption that distribution businesses will have little difficulty in establishing compliance in time for a July 2012 implementation of the NECF is simplistic, and does not appreciate the multiple difficulties which distributors face. Additionally, much work remains to be done by the jurisdictions in formulating the full compliance frameworks.

AER classification of regulatory obligations and reporting

Jemena submits that the AER should identify specific Type 1 obligations by applying its own formulated test i.e. the obligations should be those where a breach 'is likely to have a critical impact on customers'. Accordingly, the listing of Type 1 obligations in Appendix 1 of the draft compliance procedures and guidelines should by reference to the rule number rather than at an entire division level.

Compliance pro-forma and corporate sign-off

The AER has seemingly withdrawn a requirement for Chief Executive Officers to formally acknowledge Division 137 of the Criminal Code Act 1995 (Cth) in pro forma compliance statements submitted to the AER. However, the revised versions of the pro-forma statements included in the draft guidelines are not clear in this respect.

2. Business readiness and compliance

Jemena submission

In its February 2011 submission, Jemena welcomed the draft decision's statement that 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 occurring¹.

¹ AER, *Approach to compliance with the National Energy Retail Law, Rules and Regulations*, Draft Decision, p. 8.

At the same time, Jemena noted that individual jurisdictions may implement only some parts of the NECF before other parts – or not implement them at all – and that this would complicate the monitoring activity which the AER intended to rely upon to determine business compliance.

Further, Jemena discerned potentially major differences in NECF preparedness between gas and electricity distribution which are likely to require separate approaches to monitoring and enforcement by the AER in the introductory years of the NECF.

Jemena submitted that the AER guidelines could usefully recognise a transitional period until businesses were ready to implement the NECF to the extent provided in jurisdictional legislation.

AER response - overview

It is apparent from the brief extracts below that:

- the AER expects all businesses to be fully compliant with their NECF obligations from 1 July 2012
- the AER will not consider any ‘transitional’ period past that date for a business to establish compliance
- the AER will begin its annual (or more frequent) compliance review activity immediately the NECF comes in.

AER response – business readiness

While recognising that changes in the nature of regulatory obligations may require corresponding changes to business systems and practices, the AER nevertheless states that²:

- The MCE engaged in extensive consultation on development of the Customer Framework prior to the public release of the Law and Rules in November 2010
- This has allowed a considerable period of time for regulated entities to begin planning these changes
- Our expectation is that regulated entities will continue this preparatory work between now and 1 July 2012, to ensure their readiness to comply with obligations
- Processes for implementation in each jurisdiction are continuing and will allow regulated entities to refine their systems in time for commencement.

AER response - no transitional period for compliance

While several businesses had requested a period of leniency to establish compliance, the AER states that:

- It is not possible for the AER to fetter its discretion to use particular monitoring or enforcement mechanisms available to it under the Customer Framework
- Nor can it pre-judge such decisions on an in principle basis by committing not to use them for a pre-determined transitional period
- By consulting on and releasing the guideline ahead of the transition date, we have sought to give regulated entities adequate time to identify and implement any changes required³.

² *AER Compliance Procedures and Guidelines National Energy Retail Law, Retail Rules and Retail Regulations – Notice of draft instrument*, 23 March 2011, p. 3.

³ *Op. cit.*, pp 3-4.

Jemena comments on AER responses

It appears to Jemena that the AER has seriously underestimated the nature and extent of the tasks facing distributors in preparing for the introduction of the NECF.

At this stage there are very large differences between the extent to which each of the electricity and gas businesses in each jurisdiction can comply with the new NECF obligations. Consequently, there is a need for jurisdictions to put in place exemptions or transitional provisions that reflect what is practically and economically feasible in each case and over time.

Like all distribution businesses across Australia, Jemena needs certainty as soon as possible as to what jurisdictional exemptions will be put in place. Each jurisdiction has commenced processes (some more advanced than others) to determine what exemptions are required.

Given that Jemena owns or partially owns distribution businesses in three jurisdictions (NSW, Victoria and the ACT), we have been monitoring NECF developments very closely at both a national and state level. Given also that Jemena wholly owns the major gas network in NSW and one of the Victorian electricity networks, we are also able to discern some key differences between gas and electricity, namely:

- Gas networks do not have any contractual relationship with end users (except self contracting users). The NECF requirements for ongoing direct obligations to end users will necessitate a major re-engineering of gas business processes and procedures, including IT.
- Gas access arrangements contain the terms and conditions for access to the network. The contractual relationship is between the distributor and retailer. The NECF will now require contractual relationships to be established between distributors and end users. At some point, existing access arrangements will have to be modified to be consistent with provisions of the NECF which establish the new end-user contractual relationships.
- Electricity distributors in most jurisdictions are relatively better placed to accommodate the NECF than gas distributors. This is because many electricity distributors already have a 'deemed' contractual relationship with end-users, and may also have connection procedures which deal directly with end-users.
- Nevertheless, electricity distributors also have major transitional issues, especially where some current jurisdictional legislation is intended to operate beyond 2012, but which deals with NECF matters in a different way.

All distributors face the uncertainty of not knowing what parts of their jurisdictional frameworks will be retained under the NECF (e.g. licence conditions) and what parts will be dispensed with. Jemena is not aware of any jurisdiction having made significant progress in this area.

As noted earlier, all distribution businesses across Australia need certainty as soon as possible as to what jurisdictional exemptions will be put in place. The only jurisdiction which appears to have done this with any certainty is Queensland, which issued a NECF implementation decision paper in March 2011⁴. Among other things, Queensland has:

⁴ http://www.dme.qld.gov.au/Energy/national_energy_customer_framework.cfm

- allowed 'grace periods' for the transition to certain NECF contracts (both gas and electricity)
- delayed the application of certain aspects of the new electricity connections framework until 1 July 2015
- delayed a requirement for AER approval of electricity connection offers until 1 July 2015

Jemena summary on business readiness

In view of the extensive array of unresolved distributor issues outlined above, Jemena cannot see how the AER can maintain the view that

[there has been} a considerable period of time for regulated entities to begin planning these changes

Rather than the planning process having ended in November 2010 as the AER implies, the passing of the National Energy Retail Law and Rules on 17 March 2011 has merely started the process in earnest. Given the vast amount of work to be undertaken by distributors Australia-wide, and the fact that many uncertainties may still be unresolved at 1 July 2012, Jemena finds the AER's dismissal of a transition period to establish distributor compliance to be both disappointing and potentially unrealistic.

3. AER classification of regulatory obligations and reporting

Jemena submission

The draft AER guidelines proposed three types of regulatory obligation with attendant reporting requirements.

Jemena submitted that the guidelines' classification of Type 1 must be more discerning and target only those obligations that have major implications. It was burdensome, costly and unnecessary to lump all distributor de-energisation breaches into Type 1, when clearly the most serious breach would be the wrongful de-energisation of life support equipment (NERR part 6, rules 116 and 120).

Jemena was strongly of the view that that the AER should not include all of the subdivisions under *distributor de-energisation of premises* and *prepayment meter systems* obligations as Type 1 matters.

AER response and Jemena comments

In response, the AER has noted:⁵

- The obligations in the divisions for which reporting requirements proposed are closely related, so that single course of conduct is likely to be captured by multiple obligations.
- The AER's proposal to classify groups of related provisions, rather than fragments within a suite of related provisions, reflects our expectation that obligations are approached in context.
- The AER expects internal policies, systems and procedures developed by regulated entities to monitor their compliance with the Customer Framework to capture the combined effect of all obligations relating to a particular behaviour.

⁵ *AER Compliance Procedures and Guidelines National Energy Retail Law, Retail Rules and Retail Regulations – Notice of draft instrument*, 23 March 2011, p. 14.

- We are not persuaded that reclassification of these subdivisions and divisions is appropriate.
- If it becomes apparent that the level of scrutiny through reporting requirements is excessive or unwarranted, we will initiate consultation under the Retail Rules to explore appropriate amendments to the guideline.

Jemena does not have any issues with the AER's response per se, and agrees with the AER that individual obligations should not be considered in isolation. But the issue here is whether all the related provisions in a particular division or subdivision warrant reporting at the level required for Type 1.

Jemena considers that by including an entire division or subdivision for Type 1 reporting, the AER's approach does not give a very important obligation the prominence it deserves. Jemena observes that any non-compliance with an obligation related to a Type 1 obligation will be reported in the 6-monthly and annual compliance reports, and thus will not escape AER scrutiny.

As an example, Appendix A.1 of the draft compliance guidelines lists as a Type 1 obligation the entire NERR, part 6, division 2 – "retailer-initiated de-energisation of premises". Within division 2, Jemena considers there is good reason for the AER to classify a breach of rule 116 as Type 1. This is a 'must not' obligation involving de-energisation of premises registered as having life support equipment.

But Jemena is not convinced that a breach of rule 118—where the retailer has not used its best endeavours to de-energise in accordance with the customer's request—has equivalent importance to that of Rule 116. Jemena notes that the other obligations in division 2 simply relate to the rights of a retailer to de-energise.

In part 6 division 3, Jemena observes that rule 120 (the equivalent distributor rule to rule 116) is the only obligation that should be identified as Type 1.

Additionally, Jemena urges the AER to identify the key obligations in parts 2 and 7 where a breach is likely to have a critical impact on customers, and thus warrant inclusion as Type 1.

The AER's own tests for Type 1 and Type 2 obligations are as follows:⁶

Type 1: Regulatory obligations where 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 2: Obligations where a breach is likely to have a serious impact on customers - and is likely to escalate or become widespread in the medium (three to six months) term if steps are not taken to rectify it.

Jemena submits the AER should identify specific Type 1 obligations by applying the above criterion i.e. the obligation must have "*a critical impact on customers*". Accordingly, the listing of Type 1 obligations in Appendix 1 of the draft compliance procedures and guidelines should by reference to the rule number rather than at a divisional level.

Jemena has no issue with Type 2 and 3 obligations being classified at a divisional level.

⁶ AER, *Statement of approach: compliance with the National Energy Retail Law, Retail Rules and Retail Regulations*, 23 March 2011, p. 10.

4. Compliance pro-forma and corporate sign-off

Jemena submission

Jemena considered that the calling up of the Criminal Code Act in the proposed compliance statements was totally unnecessary and was inconsistent with compliance statement wording already used in other industry compliance statements and regulatory accounting statements.

Jemena submitted that the last two paragraphs in pro-forma numbers A1 and A2 of the draft guidelines (now B1 and B2) should be replaced with words which were modelled on the current compliance reporting statements in Victoria.

AER response and Jemena comments

The AER has amended the guidelines to allow the CEO to delegate responsibility for approval of immediate reports on Type 1 obligations to a suitably qualified person within the organisation.

Instead, the CEO will be required to approve a consolidated report of all such breaches at the end of every six-month period, and to submit that report together with the report on Type 2 breaches for the relevant period.

In addition, the AER has omitted the following words from pro-forma numbers B1 and B2:

“I solemnly and sincerely declare that this report prepared by [regulated entity] to the AER is:

1. true and accurate to the best of my knowledge and belief;
2. in accordance with the AER’s compliance Procedures and Guidelines.

I acknowledge that Division 137 of the Criminal Code Act 1995 (Cth) makes it a serious offence to give false or misleading information to the AER knowing it to be false or misleading or omitting any matter or thing without which the information is misleading.”

The pro forma now reads as follows:

“This report has been prepared by [regulated entity] with all due care and skill and in accordance with the AER Compliance Procedures and Guidelines. Throughout the period covered by this report [regulated entity] had effective policies, systems and procedures in place to monitor compliance with the National Energy Retail Law, Rules and Regulations, established and observed in accordance with the AER Compliance Procedures and Guidelines.”

However, the AER has inserted the following statement as a footnote after the Chief Executive Officer’s signature:⁷

“Failure to comply with the AER Compliance Procedures and Guidelines is a breach of the Retail Law, and may attract civil penalties. If a corporation contravenes this obligation to comply, each officer of the corporation is to be taken to have contravened this obligation if the officer knowingly authorised or permitted the contravention or breach. An officer of a corporation may be proceeded against whether or not proceedings have been taken against the corporation itself.

The Criminal Code Act 1995 (Cth) makes it a serious offence to give false or misleading information to the AER knowing it to be false or misleading or omitting any matter or thing without which the information is misleading”.

⁷ AER Draft Compliance Procedures and Guidelines – National Energy Retail Law, Retail Rules and Retail Regulations, 23 March 2011, pp. 24-25.

Jemena questions whether this additional statement retains a requirement to formally acknowledge the Criminal Code Act in the proposed compliance pro forma. While the statement by itself is factual, its proximity to the Chief Executive Officer's signature implies (in Jemena's view) that the compliance pro forma has been prepared with explicit CEO acknowledgement of the Criminal Code Act 1995 (Cth). This seems at odds with s 274 of the NERL which places an obligation on the regulated entity and not any individual.⁸

5. Compliance audits

Jemena submission

Section 4 of the draft guidelines set out a range of requirements covering compliance audits of the regulated entity. However, the section was silent on the audited entity having any opportunity to review the audit report before it was submitted to the AER.

Jemena suggested that a clause be added to section 4 signifying that the regulated entity had been provided with a copy of the final audit report and had agreed to the findings and recommendations.

AER response and Jemena comments

In the latest 'notice of draft instrument', the AER has included the following statement as part of its response to stakeholder submissions on compliance audits:

"Where appropriate, the AER may require an independent auditor to produce a draft audit report for review before the report is finalised. In these cases the AER may also give the audited party an opportunity to review the draft report for any errors of fact."⁹

Jemena welcomes this assurance, and considers that it is in line with established regulatory practice.

⁸ In Jemena's view, the Criminal Code Act is about individual offences not that of companies.

⁹ *AER Compliance Procedures and Guidelines National Energy Retail Law, Retail Rules and Retail Regulations – Notice of draft instrument*, 23 March 2011, p. 21.