

11 February 2010

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

Dear Mr Leuner

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

Simply Energy thanks the Australian Energy Regulator (AER) for an opportunity to comment on the AER's draft decision relating to its approach to compliance.

For retailers, the National Energy Customer Framework (NECF) combines a series of new or modified regulatory obligations with a more punitive compliance and enforcement regime. This presents a significant step change in regulatory compliance risk, involving sharper potential sanctions for non-compliance with obligations that retailers will still have limited experience in complying with.

To address these risks, Simply Energy suggests that the AER phase-in its compliance approach, in recognition that both it and regulated entities will need some time to settle into the new regulatory arrangements. An example of such phasing might be an initial 18-month period in which the more escalated forms of enforcement (e.g. penalties, audits) would not be undertaken. We believe this would strike the right balance between allowing for robust and appropriate regulation, and ensuring that the compliance challenges associated with the NECF are managed fairly and sensibly.

Our comments on the AER's proposed compliance framework centre on the lack of detail that the AER has provided on what processes and procedures the AER will use to engage with retailers on compliance and enforcement activities. At present, there is insufficient detail contained in the proposed Compliance Procedures and Guidelines for retailers to understand how the AER will approach audits and enforcement activity and thus very little guidance on how the retailers can cooperatively assist the AER.

To discuss our comments in response to the AER's draft, we have considered the compliance framework under three broad headings — reporting requirements; compliance checking; and enforcement procedures.

Reporting requirements

Simply Energy supports the framework that the AER has set out in relation to the reporting of compliance breaches under the Type 1, Type 2 and Type 3 categories. We also support the reporting timeframes that have been set out by the AER under each of these breach categories.

However, we strongly object to the AER's proposal that reporting requirements apply to "potential" compliance breaches, rather than actual breaches. Such a requirement is not envisaged in the NECF, and the subjective nature of defining what constitutes a potential breach will result in significant mis-reporting by retailers.

Jurisdictional reporting regimes work on the basis of confirmed compliance breaches. The normal courtesy extended by retailers to regulators is to informally discuss any significant issues that affect customers but do not involve strict non-compliance. It is not clear why such an approach is not suitable to the NECF.

Compliance checking

Under the heading of ‘compliance checking’, we have grouped regulatory audits and performance audits.

Simply Energy noted PIAC’s recommendation and repeated in the AER’s Draft Decision that the AER should access a retailer’s internal dispute data and explore ways to make this publicly available.¹

Simply Energy has serious concerns about whether this would be allowed under privacy legislation. To allow this access to occur, Simply Energy would need to contact each and every one of its customers to obtain the right to allow a third party to see their personal information. This would involve extensive resources to explain to the customer the reason for a third party request to access their private information. It will also involve the AER setting out clearly for communication to customers how their personal data will be used. It will be necessary for the AER to draft these words — retailers cannot do this for the AER because retailers do not know what the AER will do with the data.

There is also significant potential for the loss of control of personal data that could quickly end up in the public domain.

Our other comments on compliance checking relate to Chapter 4 “Compliance Audits” of the *Compliance Procedures and Guidelines*.

Audits have six key stages:

1. The decision to audit
2. Determining the scope of the audit
3. Appointing the auditor
4. Carrying out the audit
5. Considering the audit draft report
6. The final audit report

So that retailers can make an effective contribution at each stage of the audit process and understand what the regulator’s expectations are and thus ensure a useful and timely response, the Guideline needs to set out how the AER will engage with retailers at each of these stages. In current form, the Guideline provides insufficient detail on the process for conducting audits.

We consider the content of the proposed Guideline against each of these stages.

The decision to audit

The current draft of the *Compliance Procedures and Guidelines* does not contain criteria that the AER will use to decide when and how frequently audits will occur. The AER touches on what factors it may consider in deciding to undertake an audit in its Draft Decision.² However, the Guideline itself is strangely quiet on what factors will be considered by the AER in considering the need for an audit.

¹ AER 2010 Approach to Compliance with the National Energy Retail Laws, Rules and Regulations, Draft Decision, p. 10
² *ibid*, p. 21

We encourage the AER to include the factors it touches on in its Draft Decision in the Guideline itself so that the Guideline remains consistent with the Draft Decision. Drawing on the AER's Draft Decision, we consider the following criteria appropriate:³

The AER may decide to commence an audit process where:

- 1. an audit would maximise value to both the regulated entity being audited and the market as a whole, and*
- 2. there are issues of concern identified through compliance monitoring activities.*

We suggest that these criteria be inserted into Chapter 4 of the Procedures and Guidelines as a new section 4.2.

Determining the scope of the audit

Simply Energy is supportive of the provisions currently contained in section 4.3 of the draft Procedures and Guidelines. However, there are a couple of additions that could be made to the Guideline to make it an even more useful tool.

First, the fact that the AER will consult the regulated entity when developing the terms of reference for the audit is welcome. Experience has shown that often retailers have suggested to the regulator to include additional items in the audit so that the retailer can use the audit as an opportunity to test internal processes.

We have no objections to the AER imposing a period within which submissions on the scope can be made. However, it is important for the AER to understand that the notification of an impending audit typically comes through a retailer's regulatory team. A retailer's regulatory team requires time to engage with other divisions within the retailer to discuss the audit scope and to formulate comment on the proposed scope. Consultation within the business can often take weeks rather than days because other business divisions obviously have their own business priorities to resource.

To recognise this, we encourage the AER to adjust clause 4.3.2 to "... and may specify a period *not less than four weeks* within which submissions ..."

Second, the Guideline also needs to make clear what consultation process on the audit scope will occur after the closing date for the first round of submissions. When the AER embarks on its first retail audit, it will discover that determining the scope of the audit is an interactive process, involving ongoing dialogue between the regulator and the retailer as preparation for the audit will often throw up the need to adjust the audit scope to ensure it delivers on the AER's objectives. The AER will find that one round of consultation on the scope will be insufficient if the audit is to be effective.

Appointing the auditors

The Compliance Procedures and Guidelines are silent on the process for appointing auditors and on what skills and experience the auditors should have. We encourage the AER to review the ESCV's Guideline 22, Chapter 3 as an example of the type of information that should be included in the Guideline.

We strongly encourage the AER to adopt the Tripartite Deed approach to appointing the auditors that has been used by state jurisdictional regulators. The Tripartite Deed is the tool which places the obligation on the auditor to undertake the audit using recognised audit procedures and employing recognised skills and

³ *ibid*, p. 21

experience. In other words, it binds the auditor to the requirements of the Compliance Procedures and Guidelines. Importantly, the tripartite approach makes the auditor as responsible to the regulator as to the regulated entity and thus removes any potential for suggestion that the audit is compromised by being skewed either in the regulator's or regulated entity's favour.

There will be a contract to engage the auditor. However, these contracts only cover the financial arrangements between the contractor and contractee. It does not include the framework that the auditor must use to undertake the audit and the skills and experience that the auditor must employ.

Undertaking the audit

In current form, the Compliance Procedures and Guidelines provide no guidance to the auditor or retailer on the framework or methodology that should be used or considered for assessing and reporting on compliance. How is the auditor to grade compliance? What criteria should be used? How is data accuracy determined?

Considering the audit draft report

Simply Energy presumes that the auditors will be required to produce a draft report for comment. This is not stipulated in the Guidelines, nor is it stipulated that the auditor must produce any form of report. The Guideline is also silent on what form the report should take and whether the auditors are required to sign off on the report.

Conclusion

Simply Energy strongly encourages the AER to think again about the content of the Compliance Procedures and Guidelines. We also encourage the AER to undertake a second round of draft report consultations because of the extensive changes that will need to be made to the Guidelines before they can be finalised. Plenty of time remains for the AER to undertake further consultation on this issue.

Simply Energy would be pleased to assist the AER in further thinking about what content should be in the Compliance Procedures and Guidelines.

Enforcement procedures

The final issue that Simply Energy wishes to comment on is the lack of detail contained in the Statement of Approach and Compliance Procedures and Guidelines on how the AER will engage with retailers when a compliance breach is identified. In its current draft, the Approach and Guideline documents are largely silent on what steps and/or information the retailer can expect from the AER during its deliberations on whether to undertake enforcement action and what form the enforcement action will take. For example, can the retailer expect to have the opportunity to engage with the AER before an administrative and/or statutory enforcement action is taken?

More detail is required in the Approach and Guideline documents to provide some certainty to the retailer about the steps that will be followed by the regulator. Simply Energy takes compliance breaches extremely seriously primarily because they can damage our reputation with customers. Often compliance breaches can occur because of simple mistakes on the part of the retailer and sometimes on the part of the customer (such as not supplying the retailer with the correct information). They can also occur because of decisions taken upstream of the retailer, such as by network operators, but about which the retailer has not been kept informed.

The AER must establish a process for dialogue between the regulator and retailer so that the reasons for the breach can be identified and to provide reasonable time for the retailer to undertake corrective action. This

process needs to occur prior to any consideration of more formal administrative and/or statutory enforcement actions.

Retailers must be provided the opportunity to correct non-compliant behaviour before any form of administrative or statutory sanction is imposed. Otherwise the regulator is not engaging in due process.

In its current form, the Approach and Guideline documents provide good detail on what the regulator expects of retailers on the reporting of compliance breaches. However, there is very little commensurate detail on what retailers can expect from the AER in response.

Conclusion

Simply Energy encourages the AER to consider further whether the Statement of Approach and Compliance and Procedures Guidelines documents provide sufficient detail on the process for engagement between the AER and retailers for satisfactory compliance outcomes. We re-emphasise our belief that the AER needs to undertake a further round of consultations on both documents prior to finalising them. There is still near on 18 months (at least) before the AER takes up its retail responsibilities and thus more than sufficient time to undertake another round of consultation.

We would be pleased to discuss this submission with the AER further if this would be of assistance. You can contact me on (03) 8807 1132.

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