

**REVIEW OF  
ELECTRICITY AND GAS  
LICENSING REGIMES IN NSW**

**FINAL REPORT**

**INDEPENDENT PRICING AND REGULATORY TRIBUNAL  
OF NEW SOUTH WALES**



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ELECTRICITY AND GAS  
LICENSING REGIMES IN NSW**

**FINAL REPORT**

**S9-9**

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# 1 INTRODUCTION

The Minister for Energy has asked the Tribunal to recommend changes to licence and authorisation conditions or licensing administrative arrangements that will improve licence and authorisation holders' compliance with Government policies.<sup>1</sup>

For the purposes of this review, the Tribunal has:

- released an issues paper and received submissions from interested parties<sup>2</sup>
- engaged NERA to prepare reports on (1) the most effective regulatory model for energy licensing in NSW, (2) a framework for compliance monitoring and reporting and (3) issues in setting minimum performance standards<sup>3</sup>
- held a public forum on licensing on 19 March 2002
- released a draft report in June 2002 and received submissions from interested parties.<sup>4</sup>

The draft report made seven policy recommendations to the Minister, dealing with changes to licence conditions. It also set out in some detail how the Tribunal proposes to administer the energy licensing regime.

This final report confirms the seven policy recommendations to the Minister. Aside from issues of clarification, there was broad support for these recommendations. The Tribunal has added a new recommendation, that the Minister consider no longer requiring LPG businesses to be licensed.

Stakeholders also made a range of constructive suggestions on the Tribunal's proposed administrative arrangements. To address these, the Tribunal has more explicitly described procedural fairness and timing issues, and intends to continue to work with stakeholders to complete the documenting of the regime.

This final report concludes an important 'overhaul' of the compliance reporting and administrative arrangements supporting the regime. However, the approach established should deliver cost-effective, flexible administration and a focus on continuous improvement of the regime. The Tribunal will continue to work closely with Government, licensees and other stakeholders to ensure its administration of the regime continues to cost-effectively supports compliance with Government energy policies.

## 1.1 Scope of the review

Previous reports by the former Licence Compliance Advisory Board<sup>5</sup> and the Tribunal<sup>6</sup> argued that electricity licence conditions should be focussed more explicitly on Government policy objectives, and that the electricity licensing regime needed more rigorous, independently audited compliance reporting. Electricity licence holders had also questioned

<sup>1</sup> The terms of reference are reproduced in Attachment 1.

<sup>2</sup> IPART, *Review of Electricity and Gas Licensing Regimes in NSW — Issues Paper*, DP44, June 2001.

<sup>3</sup> These reports are available at [www.ipart.nsw.gov.au](http://www.ipart.nsw.gov.au)

<sup>4</sup> IPART, *Review of Electricity and Gas Licensing Regimes in NSW – Draft Report*, S9-8, June 2002.

<sup>5</sup> Licence Compliance Advisory Board Annual Report 1999, *Report to the Minister for Energy and Minister for Fair Trading on Licence Condition Compliance by Licensed Electricity Distributors and Retail Suppliers in New South Wales in 1998-99*, October 1999.

<sup>6</sup> IPART, *Electricity distribution and retail licences: compliance report for 1999/2000*, CP-5, 21 December 2000.

the value of many of the electricity key performance indicators and were critical of the way in which the regime had been administered.

The absence of an annual compliance reporting cycle or key performance indicators in gas meant that few compliance issues were apparent. However, the Minister asked IPART to also review the effectiveness of the gas licensing regime in anticipation of full retail competition (FRC). Under FRC, the retail markets for natural gas and electricity have effectively converged, making it more important that they be subject to the same conditions and compliance monitoring.

During 2001/02, the Government extended and clarified the conditions applying to electricity and natural gas retail supply to implement FRC. At the Tribunal's request, the Minister also changed some electricity key performance indicators. More recently, the Government has decided to overhaul the licence conditions relating to greenhouse gas emissions from electricity production. Together, these policy changes have focussed most electricity conditions on well-defined policy objectives, and have effectively standardised many of the conditions applying to electricity and natural gas retail supply.

However, the FRC reforms have added to the importance of improving the administration and compliance monitoring of the now more comprehensive energy licensing regime.

This report focuses on the issues of:

- improving and standardising the administration of the regime
- establishing a rigorous framework for monitoring, auditing and reporting compliance with electricity and gas conditions
- reviewing the effectiveness of some pre-FRC electricity and gas conditions which the Government did not address as part of its FRC reforms.

In response to the draft report, EnergyAustralia and AGL argue that the Tribunal should also review the effectiveness of conditions introduced to support FRC from 1 January 2002.<sup>7</sup> However, the Tribunal continues to believe it is not appropriate to review these FRC-related conditions at this time. Given their recent introduction, they clearly reflect current Government policy, and businesses are still in the process of fully implementing systems to ensure their compliance.

In any event, the annual compliance reporting cycle (see section 2.3.2) will provide a periodic opportunity for businesses and the Tribunal to provide feedback to the Minister on the effectiveness of all conditions. In addition, the Tribunal's Reporting Manuals (see section 2.1.2) should provide a practical means of addressing any ambiguity as to what is required to demonstrate compliance with particular conditions.

Industry stakeholders have argued that compliance with legal obligations is an integral part of their businesses, one on which they expend considerable time and resources. Consistent with current research on improving compliance,<sup>8</sup> the Tribunal believes it is important to recognise and support businesses' pre-existing commitment to compliance.

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<sup>7</sup> EnergyAustralia submission to IPART, *Review of Electricity and Gas Licensing Regimes in NSW - Draft Report*, August 2002, pp 15-16; AGL submission, August 2002, p 3.

<sup>8</sup> OECD, *Reducing the risk of policy failure: challenges for regulatory compliance*, 2000.



However, given the range of FRC-related obligations, some lapses in compliance are inevitable, particularly in the early stages of FRC, where the application of licence/authorisation obligations may require further clarification. Strong, but cost-effective compliance monitoring will be essential to support FRC. The Tribunal needs to strike the right balance between relying on businesses to manage their own compliance and active compliance monitoring.

The Tribunal intends to adopt measures designed to support a strong culture of compliance among all energy businesses operating in NSW.<sup>9</sup> At the same time, the traditional regulatory activities of monitoring and enforcement play an essential role in ensuring that appropriate incentives are in place to encourage compliance.

Chapters 2, 3 and 4 of this report explain how the Tribunal intends to carry out its licensing functions so as to improve the administration of the regime and the monitoring, auditing and reporting of compliance. These chapters also recommend to the Minister some new licence and authorisation conditions required to support the Tribunal's new administrative arrangements.

In chapter 5, the Tribunal reviews the effectiveness of, and recommends amendment or removal of, those pre-FRC electricity and gas conditions which were not addressed as part of the FRC reforms.

## 1.2 Overview of the report

### ***Chapter 2 — Administering the regime in a transparent way***

Chapter 2 describes how the Tribunal intends to make the licensing regime more transparent. Greater transparency will make it easier for businesses and the Tribunal to fulfil their obligations and for other stakeholders to understand the operation of the regime. By ensuring that the regime is clearly documented —through Consolidated Reference Documents, Reporting Manuals and transparent relationships between agencies— the Tribunal hopes to avoid misunderstandings regarding the content of licence/authorisation obligations.

The Tribunal will continue to report to the Minister in October each year on electricity businesses' compliance with licence conditions during the previous financial year. The Tribunal intends to implement a parallel reporting cycle for natural gas businesses' compliance. Additionally, the Tribunal intends to disseminate information about compliance issues by publishing an annual report to stakeholders and by hosting a regular forum for compliance officers and other interested parties.

The Tribunal's proposed compliance and monitoring framework includes an annual cycle which will continue to refine the administration of the regime and generate recommendations on fine-tuning licence conditions to ensure they best reflect Government policy objectives.

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<sup>9</sup> Attachment 2 explains why a licensing regime that actively supports a culture of compliance is likely to achieve a higher overall level of compliance than a regime that seeks merely to identify and respond to contraventions.

### **Chapter 3 — Cost effective compliance monitoring**

Chapter 3 considers the processes required to effectively monitor compliance in a way that does not impose excessive costs. The Tribunal proposes that the current monitoring regime be replaced by a system which focuses on the adequacy of businesses' internal compliance systems and requires reporting of non-compliances only. Over time, each business's compliance reporting burden will adjust in accordance with its compliance record. In addition, the Tribunal will streamline its compliance monitoring activities with monitoring currently undertaken by other licensing-related agencies in NSW.

### **Chapter 4 — Incentives to comply and credible enforcement**

An effective way for the Tribunal to support an industry-wide culture of compliance is to provide incentives for businesses to comply. Chapter 4 focuses on establishing a transparent and credible enforcement regime that responds to breaches in a proportionate manner. A balanced and clear-cut approach to enforcement is fairer to businesses than an opaque approach where businesses are unsure where they stand.

### **Chapter 5 — Ensuring that conditions reflect the new regime**

Some conditions are remnants of the (pre 1 January 2002 FRC) self-regulatory approach to licensing, or do not reflect more recent institutional responsibilities. Such conditions should be deleted. Conversely, some new licence conditions are needed to facilitate the Tribunal's approach to licence administration.

## **1.3 Summary of recommendations**

### **1.3.1 New conditions to support licence administration**

#### **Recommendation 1**

***The Tribunal recommends that the Minister impose a new condition requiring electricity businesses to report in accordance with the Tribunal's Reporting Manuals.***

This condition will bring electricity and gas compliance reporting into alignment as the Tribunal already has power under the Gas Supply Act to require gas authorisation holders to report in this way.

#### **Recommendation 2**

***The Tribunal recommends that the Minister impose a condition requiring electricity and natural gas businesses to maintain compliance management systems capable of managing their compliance with their electricity licence or natural gas authorisation.***

This condition will help focus the regime on the adequacy of businesses' compliance management, rather than their capacity to write compliance reports. It will encourage all NSW energy businesses to adopt the rigorous approach to compliance management that most have already implemented.

However, to have the intended incentive effect, businesses with robust compliance systems will need to be rewarded with fewer, less extensive compliance audits and reports.

### Recommendation 3

***The Tribunal recommends that the Minister impose a condition requiring electricity and natural gas businesses to report operating statistics as specified by the Minister.***

Currently natural gas businesses report certain statistical information on a voluntary basis, while electricity businesses report similar information under a mandatory Ministerial Guideline. The recommended condition would standardise and simplify the legal basis of this reporting, by bringing any such reporting under a specific licence condition.

While the proposal is essentially ‘house-keeping’, some action is required as the Tribunal intends to replace the relevant Ministerial Guideline with its Reporting Manuals. The Tribunal does not propose any change to the information reported as this is a policy issue for the Government.

#### 1.3.2 Removing duplicated or redundant electricity conditions

### Recommendation 4

***The Tribunal recommends that the Minister revoke electricity DNSP and retail licence Conditions 3.7 and 3.8, which require licensees to submit and report against licence plans, as the relevant policy areas are covered elsewhere in the regulatory regime.***

Electricity licence plans and reports were a central feature of the former, self-regulatory approach to licensing. Some businesses took these obligations in the spirit they were intended and submitted comprehensive plans documenting aspects of their corporate planning and management systems. Others stuck more closely to a literal interpretation of these vaguely-defined obligations, and submitted documents of little weight or value. In either case, the regulator did not appear to make much use of the information.

Further, this internal scrutiny of businesses’ planning seems much less relevant to the current regime with its sharper focus on market competition for large customers and consumer protection for small retail customers. On balance, the Tribunal believes the cost-effectiveness of the regime could be improved by removing these obligations.

### Recommendation 5

***The Tribunal recommends that the Minister revoke, for the 2002/03 reporting year and thereafter, his guidelines on independent appraisal of electricity licensees’ compliance reports as auditing of compliance is adequately dealt with in the Tribunal’s compliance auditing framework.***

Currently, electricity businesses must have their annual compliance reports independently assessed each year. The required assessment standard is poorly defined, again resulting in highly variable quality of assessments. Natural gas businesses are not required to report or to have their compliance independently assessed.

The Tribunal wishes to follow a consistent approach when assessing electricity and gas businesses’ compliance, and for that approach to use external assessment less frequently, but to a higher, audit standard. Removing the Ministerial Guidelines on independent appraisal (to be effective from 2002/3) will facilitate this more flexible auditing approach and reduce compliance reporting costs.

## Recommendation 6

***The Tribunal recommends that the Minister remove electricity retail licence Condition 3.5.3 as the Energy Marketing Code requires disclosure of more extensive and useful information to small retail customers.***

This condition no longer serves the Government's policy intent as there are no franchise customers. The new Marketing Code of Conduct comprehensively states relevant obligations in this area, making Condition 3.5.3 redundant.

## Recommendation 7

***The Tribunal recommends that the Minister revoke electricity retail licence Condition 3.6, relating to supply to 'exempt persons' (landlords), as customers (tenants) of exempt persons have recourse to the EWON and, if separately metered, access to the contestable market.***

This condition has been suspended since 1997 with no apparent impact. While it is clearly an important policy area, this condition does not appear to currently provide any consumer protection or to be a part of any future plans to reform this area.

### 1.3.3 Standardising pre-FRC natural gas authorisation conditions

The Tribunal and the MEU are conducting a joint project to remove or standardise a range of pre-FRC, Ministerially-imposed natural gas conditions. The significant differences between different authorisations typically reflect historical issues that are no longer relevant. In the converging energy market there is a strong case to simplify and standardise these conditions across gas businesses, and where possible between gas and electricity. This has already been done for conditions imposed by the legislation.

The Minister has consulted individual businesses on the proposed changes to their authorisations and will inform them of the changes when they are finalised.

### 1.3.4 Liquefied petroleum gas licences

With the introduction of the Gas Supply (Network Safety Management) Regulation 2002, the Tribunal does not believe there is a continued need to regulate, via licence conditions, LPG distributors in respect of network safety or any other matter.

## Recommendation 8

***The Tribunal recommends that the Minister remove the requirement for LPG distributors to be licensed.***

## 2 ADMINISTERING THE REGIME IN A TRANSPARENT WAY

There is a general perception among stakeholders that the energy licensing regime is complex and difficult to decipher, and that there is no clear allocation of roles between Government agencies. The Tribunal believes that improving transparency is one of the most valuable contributions it can make to the NSW energy licensing regime. The Tribunal intends to improve transparency by:

- clearly documenting the regime
- implementing a compliance reporting framework with a clear reporting cycle
- publishing an annual report to stakeholders
- hosting regular compliance forums to discuss compliance issues with stakeholders.

### 2.1 Documenting the licensing regime

For a licensing regime to be effective, stakeholders must be able to understand both the licence conditions and the regime itself. To this end, the Tribunal is in the process of developing a number of documents that aim to clarify the licensing regime.

The Tribunal is working on (or has already published):

1. **Reference Documents** that consolidate and organise by subject matter the great number of obligations enforceable by virtue of each licence or authorisation type. These obligations are imposed by various statutory instruments, and directly by the Minister. The reference documents are intended to help all stakeholders understand how each type of energy business is regulated with regard to particular subject matters.<sup>10</sup>
2. **Reporting Manuals** that exhaustively list all licence or authorisation conditions and the obligations enforceable under each condition. The Reporting Manuals also explain the annual reporting cycle, the priority of reporting, and the timing and sign-off required for compliance reports.<sup>11</sup> The Reporting Manuals will be the definitive statement of what, how and when licence and authorisation holders should report.
3. **Memoranda of Understanding** that explain and co-ordinate the licensing-related functions of various government and non-government agencies.<sup>12</sup>

These documents are intended to make it easier for businesses to comply by removing uncertainty associated with licence obligations, and to reduce compliance costs by simplifying and clarifying the regime.

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<sup>10</sup> In December 2001 the Tribunal released three consolidated reference documents covering the licence obligations applying to electricity retail supply, standard retail supply and distribution network service provision respectively. In February 2002 the Tribunal released a further three consolidated reference documents covering the authorisation conditions applying to natural gas retail supply, standard supply and reticulation respectively. Second versions of these reference documents, updated for recent changes to licence or authorisation conditions, were released in September 2002.

<sup>11</sup> Draft reporting manuals were released in December 2002 for public comment by 31 January 2003.

<sup>12</sup> The Tribunal has signed separate memoranda of understanding with EWON and the Department of Fair Trading. Further memoranda with the MEU, NEMMCO and GMC are being considered.

As well as benefiting businesses, the documents will:

- help the Tribunal and other agencies to fulfil their functions
- generate confidence in the regime by helping other stakeholders to understand it
- make it easier for new retailers to enter the market and understand their licence obligations.

The Tribunal intends to review the documents as part of the annual reporting cycle and update them as required.

### 2.1.1 Reference documents

***The Tribunal will publish and maintain reference documents that consolidate all licence and authorisation conditions in order to make the regime easier to follow.***

The licensing system serves as an enforcement mechanism for a diverse range of energy policies. As a consequence, the obligations conferred on licence and authorisation holders are fragmented across a range of policy-specific statutory instruments or other documents. To locate all obligations it is necessary to refer to a large number of source documents.<sup>13</sup> Given the inherent complexity of energy regulation, considerable research may be needed to understand all obligations applying to a particular subject matter.

The Tribunal has published Consolidated Reference Documents to bring together and reference all licence and authorisation obligations imposed under various legal source documents.

Reference documents have been prepared for:

- Electricity Distribution Network Service Providers.
- Electricity Standard Retail Suppliers and Retailers of Last Resort.
- Electricity Retail Suppliers.
- Natural Gas Reticulators.
- Natural Gas Standard Suppliers and Retailers of Last Resort.
- Natural Gas Retail Suppliers.

The reference documents are ordered by subject matter. This makes it easier to understand all the relevant rules pertaining to a particular aspect of a business. To further clarify how a subject area is regulated, the documents explain some relevant obligations (for example, safety regulations) that are not formal licence/authorisation obligations.

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<sup>13</sup> For instance, it is a condition to comply with: aspects of the *Electricity Supply Act 1995* and the *Gas Supply Act 1996*, aspects of regulations under those Acts, the Energy Marketing Code of Conduct, Market Operations Rules, the electricity Demand Management Code, the electricity Accounting Separation Code of Conduct, the gas Network Code and a number of detailed reporting requirements such as the electricity greenhouse gas emissions workbook and (indirectly) the Ministry of Energy and Utilities' network management reports.

Two narrow, but complex policy areas (relating to electricity greenhouse gas emissions and electricity metrology) have been excluded from the main reference documents as they are best understood as stand-alone source documents.<sup>14</sup>

Businesses have generally been supportive of the reference documents, although AGL suggested they could be improved by:

- in addition to referencing each obligation to the section of the statutory instrument that requires it, also referencing each obligation to the statutory provision that make compliance with that obligation a licence condition
- separately identifying those obligations which are outside the Tribunal's jurisdiction, being enforceable under the statutory instrument only, and not as licence conditions
- being updated each time obligations change.<sup>15</sup>

The Tribunal recently issued versions 2 of the reference documents, and will continue to reissue them periodically.

In respect of the first two suggestions, the Tribunal believes its Reporting Manuals will deliver this clarity of what is and isn't enforceable as a licence condition. To include this additional information in the reference documents would enlarge and complicate them. Compliance with all the obligations listed in the reference documents is required under the statutory instrument that imposes them. From the perspective of understanding how the Government regulates particular subject matters, the question of whether those obligations are also enforceable as licence conditions is not of central relevance. The primary purpose of the reference documents is as a subject-matter guide to the regime, and they perform this role best if they include all relevant obligations regardless of how they are enforced.

For the first six months of FRC, the Tribunal described its quarterly reporting requirements by reference to both the source statutory instruments and the consolidated reference documents. This led EnergyAustralia, Integral Energy and AGL to express concern that the reference documents should not acquire 'de facto' legal status.<sup>16</sup> The Tribunal acknowledges this concern and in future years, compliance reporting will be required against the Reporting Manuals only.

However, the Tribunal continues to believe there is great value in a subject-matter guide to the obligations enforceable under each licence or authorisation. It is important that all stakeholders are aware of how the regime operates. Raising awareness directly addresses one of the most common sources of compliance difficulties. It also helps to engender confidence in the regime, and to assist in identifying opportunities to rationalise obligations.

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<sup>14</sup> The workbooks and guidelines relating to electricity greenhouse gas abatement are administered as a separate compliance scheme. The electricity market operations rules on metrology are best understood when read in conjunction with the metrology procedures approved under the National Electricity Code. Compliance with the Code metrology procedures is not a licence condition.

<sup>15</sup> AGL submission, August 2002, p 7.

<sup>16</sup> EnergyAustralia submission, August 2002, p 7; Integral Energy submission, August 2002, p 3; AGL submission, August 2002, p 7.

## 2.1.2 Reporting manuals

***The Tribunal will publish and maintain Reporting Manuals that list all conditions and outline the compliance reporting requirements for each licence/authorisation type.***

The Tribunal believes it can simplify the task of reporting on compliance for energy businesses if it sets out the information it requires in a straightforward manner. It has therefore prepared draft Reporting Manuals and released them for public comments. Comments are due 31 January 2003.<sup>17</sup>

The Reporting Manuals document how and when businesses should report to demonstrate their compliance with licence and authorisation conditions. They are intended to:

- exhaustively list all conditions and obligations enforced through these conditions
- prioritise compliance reporting to focus businesses and the Tribunal on conditions that require greater monitoring
- assist businesses by simplifying the task of preparing compliance reports
- assist the Tribunal by standardising and improving the quality of the compliance information it receives.

The detailed nature of the Reporting Manuals means they are likely to require regular updating, typically annually. Also, the appropriate reporting requirements for each condition may vary over time to reflect businesses' previous compliance performance. The Tribunal believes that a process should be established so that the compliance monitoring arrangements outlined in the Reporting Manuals can be reconfirmed by the Tribunal annually or more often as necessary (see section 2.3.2).

The Tribunal already has the power to require gas businesses to report their compliance in accordance with the proposed Reporting Manuals.<sup>18</sup> At present, electricity licensees are required to report in accordance with the *Ministerial Guidelines and Requirements Policy*. To facilitate the common administration of the electricity and gas regimes, the Tribunal believes the Minister should revoke the *Ministerial Guidelines and Requirements Policy* and impose a new condition that requires electricity businesses to report in accordance with the applicable Reporting Manual issued by the Tribunal.

Businesses are generally supportive of the proposed Reporting Manuals but seek consultation on their details.<sup>19</sup> The Tribunal will work closely with the Ministry, licensees and other stakeholders to finalise the Reporting Manuals.

### Recommendation 1

***The Tribunal recommends that the Minister impose a new condition requiring electricity licensees to report in accordance with the applicable Reporting Manual issued by the Tribunal.***

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<sup>17</sup> Draft Reporting Manuals can be viewed at [www.ipart.nsw.gov.au](http://www.ipart.nsw.gov.au)

<sup>18</sup> *Gas Supply Act 1996*, s33.

<sup>19</sup> EnergyAustralia submission, August 2002, p 8; Integral Energy submission, August 2002, pp 2-3; AGL submission, August 2002, pp 78; Country Energy submission, August 2002, pp 12; Origin Energy submission, p 1; Envestra submission, August 2002, p 2.



### 2.1.3 Memoranda of understanding

***The Tribunal will agree memoranda of understanding with other licensing-related NSW agencies to improve the clarity of the energy licensing regime, enhance compliance monitoring, avoid duplication of effort and ensure a consistent approach on common issues.***

A significant number of the government and non-government organisations which monitor or regulate the activities of NSW energy businesses depend in some way on licence or authorisation conditions to support their activities. These include the:

- National Electricity Market Management Company (NEMMCO)
- Ministry of Energy and Utilities
- Energy & Water Ombudsman of New South Wales (EWON)
- Department of Fair Trading, and
- Gas Market Company (GMC).

To a greater or lesser degree, each of these organisations has an interest in the level of compliance since their operations are enforced or supported by licence/authorisation conditions.

In its review of licensing, the Electricity Association of NSW identified ‘fragmentation of regulatory responsibility’ as a problem associated with the current regulatory framework.<sup>20</sup> Whilst each agency has its own role and responsibilities, the clarity of relationships between agencies could be improved.

Where more than one body is involved in the licensing regime, both businesses and the agencies themselves will benefit if there are arrangements in place to achieve coordination and avoid reporting overlap. If businesses are to have a clear understanding of their obligations, the roles and responsibilities of the different agencies involved in monitoring compliance and administering the licensing regime should be transparent.

The Tribunal has entered into (or intends to enter into) a memorandum of understanding (MOU) with each of the organisations listed above. The MOUs set out coordination procedures and establish regular contact meetings between the agencies. They also clarify the roles of each agency. For instance, the MOU with the MEU will detail the Tribunal’s monitoring, reporting and enforcement role and MEU’s activities, particularly in relation to safety and network management.

The MOUs aim to avoid duplication of effort and to ensure a consistent approach and understanding in dealing with the NSW energy licensing regime. In the MOUs, the parties agree to:

1. Hold regular meetings, and identify contact points within their organisations to be responsible for the exchange of information.
2. Establish working procedures to ensure efficient and effective administration and communication in dealing with licensing issues and the referral of potential enforcement actions arising from those complaints.

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<sup>20</sup> Electricity Association of NSW, *Regulating and Licensing Electricity Distributors and Retail Suppliers in NSW for Public Policy Objectives — Towards Best Practice*, November 2000.

3. Share information (subject to legal constraints) necessary to enable both bodies to carry out their respective functions in a proper manner. In doing so the agencies should have respect for any personal or commercial confidentiality.

The Tribunal will publish the MOUs with various agencies, including who to contact (from each agency) by subject area.

While businesses are supportive of these efforts to coordinate the activities of licensing-related agencies, they have raised specific confidentiality issues in relation to EWON. These are discussed in section 3.4.<sup>21</sup>

## 2.2 Communicating with stakeholders

It is important that the Tribunal communicates regularly with licensees and other stakeholders about the licensing regime. Those working closely with the regime need to be well informed of emerging compliance issues or changes to administrative arrangements. They also need an efficient means of channelling any feedback to Government on how the regime could be improved.

In addition to regular contact with individual licensees, the Tribunal intends to host periodic compliance forums and to provide an annual report to stakeholders, directly addressing any issues they have raised and (re)confirming compliance reporting arrangements.

### 2.2.1 Reporting to stakeholders

***The Tribunal will report periodically to stakeholders to provide feedback on compliance issues and set out any proposed changes to the Reporting Manuals.***

At present, the Tribunal's compliance reporting is limited to providing an annual electricity compliance report to the Minister, who in due course makes the report public. The report's purpose is to inform the Minister of the extent of licensees' compliance with conditions.

The Tribunal intends to establish a similar annual compliance report to the Minister on compliance with natural gas authorisation conditions, and to report to the Minister as required on issues arising from quarterly compliance reports.

However, the Tribunal also intends to provide additional public information to help all stakeholders understand how the licensing regime is operating, and help businesses improve their compliance. As part of this educative role, the Tribunal intends to report periodically to stakeholders on:

- compliance issues that the Tribunal encounters in administering the regime or raised by businesses or other stakeholders
- generic examples of best practice compliance systems and information about possible solutions to compliance problems facing NSW energy businesses

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<sup>21</sup> EnergyAustralia submission, August 2002, pp 8 and 13; Integral Energy submission, August 2002, p 3; AGL submission, August 2002, p 10; Country Energy submission, August 2002, p 1.

- the Tribunal’s decision on any changes to the reporting requirements set out in the Reporting Manuals<sup>22</sup>
- amendments (or possible amendments) to licence/authorisation conditions which the Tribunal has or intends to recommend to the Minister.<sup>23</sup>

The Tribunal and the Minister will also undertake formal consultation processes in relation to proposed changes to the Reporting Manuals or licence conditions respectively.

Subject to confidentiality, the Tribunal would illustrate its reports to stakeholders by drawing upon issues arising during audits and other compliance monitoring activities. This may include the auditor’s views on how businesses’ compliance programs could be improved.

### 2.2.2 Regular compliance forums

***The Tribunal intends to hold regular compliance forums that will improve all stakeholders’ understanding of the regimes, and offer businesses an opportunity to improve their compliance performance through education, assistance, and consultation.***

The purpose of regular compliance forums is for businesses and other stakeholders to share their experiences and learn from the experiences of others. The Tribunal envisages that the forum would be used as an opportunity for:

- Tribunal staff to provide feedback on generic issues raised through businesses’ compliance reports and any other matters that have come to their attention
- Tribunal staff to explain and receive feedback on any proposed changes to the licensing regime (in particular, to the reporting requirements or to licence conditions)
- businesses to present case studies on successful programs
- businesses to obtain assistance on any problems that they are experiencing
- IPART to provide clarification on aspects of the regime that stakeholders consider to be ambiguous or which are causing compliance difficulties for licence holders.

While open to all stakeholders, the forum would be directed primarily towards compliance professionals who have responsibility for managing the compliance program within their organisation. Over time, the Tribunal will review the frequency of the forum in light of the type and number of issues arising.

Whilst such a forum is likely to be highly beneficial, there is potential for commercial confidentiality concerns to arise in relation to specific programs adopted by various businesses. Each business would need to make its own decision as to the extent and nature of its involvement in the forum.

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<sup>22</sup> This feature of the report to stakeholders is consistent with Integral’s suggestion that “all licence conditions and KPIs to be reported against for the given reporting year should be formally reconfirmed in writing at the beginning of the next reporting year (and done so **each** year thereafter)”.

<sup>23</sup> Section 77(2)(b) of the *Electricity Supply Act 1995* and s75A(2)(b) of the *Gas Supply Act 1996* confers this function on the Tribunal.

To date, the Tribunal has received regular feedback from businesses on difficulties experienced in complying. In a number of cases, this feedback has identified a need to modify obligations, which has then been referred on to the MEU. The MEU has recently released a consultation paper on some of these issues.<sup>24</sup>

In line with a suggestion by EnergyAustralia,<sup>25</sup> the Tribunal will publish on its website frequently asked questions (FAQs) of common compliance issues as they arise.

### 2.3 Ongoing improvement of the regime

The licensing regime should be dynamic so that it is able to adapt based on experience and respond to changing industry and regulatory conditions. This can be achieved by continuing to review licence conditions and administrative arrangements in light of how businesses respond, and whether Government's policy objectives are achieved. The MEU is currently conducting a review of certain policy issues and licence conditions.<sup>26</sup>

The Tribunal will periodically re-assess and if necessary improve its compliance monitoring framework. However, the benefits of ongoing improvement should be balanced against businesses' need for certain and stable obligations. The Tribunal will follow procedures that systematically identify areas for improvement and introduce changes with appropriate warning and implementation periods.

#### 2.3.1 Monitor the effectiveness of the licensing regime

***The Tribunal will monitor the effectiveness of the licensing regime by both monitoring and analysing compliance outcomes and seeking external feedback from businesses and other agencies.***

The Tribunal will monitor the effectiveness of the licensing regime by its scheduled compliance reporting and compliance forums, and more informal contact with stakeholder groups, businesses and the public.

In its Draft Report, the Tribunal proposed to develop a (confidential) breach register using data generated in its compliance monitoring activities. The breach register was envisaged as recording all contraventions and suspected contraventions, how (or if) the matter was resolved, and how the contravention came to the Tribunal's attention. Businesses sought access to the register and queried the process the Tribunal would follow to ensure the accuracy of the information.<sup>27</sup> In particular, they were concerned to have the right to respond to any information that alleged they had breached a condition.

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<sup>24</sup> Ministry of Energy and Utilities, *Proposed Amendments to NSW Electricity and Gas Regulations and Market Operations Rules – Consultation Paper*, September 2002.

<sup>25</sup> EnergyAustralia submission, August 2002, p 12.

<sup>26</sup> Ministry of Energy and Utilities, *op. cit.*

<sup>27</sup> EnergyAustralia submission, August 2002, p 10; AGL submission, August 2002, pp 10-11; Country Energy submission, August 2002, p 2.

On reflection, describing the register as a 'breach' register was misleading. The register was always intended to be an internal document only, to assist the Tribunal to:

- identify problem areas within the licensing regime so that it can target them to improve compliance or better focus licence obligations
- identify systemic problems in the compliance arrangements
- assess the relative effectiveness of its various monitoring activities.<sup>28</sup>

The Tribunal's annual Licence Compliance Report to the Minister is the only true 'breach register' in the sense that licensees have understood this term. Licensees are formally given an opportunity to comment on any suspected breaches before they are included in this report. As such the Tribunal has retitled the register as a 'compliance register' to reflect the fact that it records compliance-related information only, but does not distinguish whether that information amounts to a breach or not.

Before the Tribunal takes any action in relation to information on the register, it will follow due process in bringing information to businesses' attention. More broadly, the Tribunal intends to formalise and publish the due process it already follows in addressing compliance issues. This will form a part of the Tribunal's Compliance Policy (see Chapter 4).

In addition to analysing compliance outcomes, the Tribunal will periodically seek feedback on the effectiveness of the licensing regime from businesses, external auditors and other agencies:

- **Businesses**  
As businesses are at the 'receiving end' of the licensing regime, they are particularly well placed to provide useful feedback. The Tribunal invites businesses to provide comments on the effectiveness of licence conditions, reporting requirements and other administrative arrangements as an attachment to their annual compliance reports.
- **Auditors**  
In its Draft Report, the Tribunal indicated it intended to ask compliance auditors to provide feedback on the performance of the regulatory arrangements. AGL correctly argued that judgements on the effectiveness of the licensing regime are the responsibility of the Tribunal.<sup>29</sup> However, with this distinction in mind, the Tribunal believes that information from auditors can help the Tribunal make these judgements. As suggested by EnergyAustralia, the Tribunal will include a term of reference in the audit brief to this effect.<sup>30</sup>
- **Other agencies**  
The Tribunal will also discuss regulatory effectiveness at scheduled meetings with other agencies (see section 3.4). The different roles of the various agencies mean that each is in a position to provide unique insights into the effectiveness of the regime. For instance, if customers continue to raise certain issues with EWON, this may reveal

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<sup>28</sup> An inherent problem in evaluating the effectiveness of a compliance system is that an important element of effectiveness is how many contraventions the system *fails* to identify. Audits of businesses' compliance systems are one means of addressing this, however, the Tribunal should be alert to inconsistencies between different monitoring activities. For instance, if EWON receives a large number of complaints about customer transfers, but the compliance reports reveal no problem in this area, the reporting requirements may need to be reformed.

<sup>29</sup> AGL submission, August 2002, pp 11-12.

<sup>30</sup> EnergyAustralia submission, August 2002, p 10.

that particular conditions are poorly targeted or otherwise failing to achieve their policy objectives.

### 2.3.2 Use feedback to improve the licensing regime

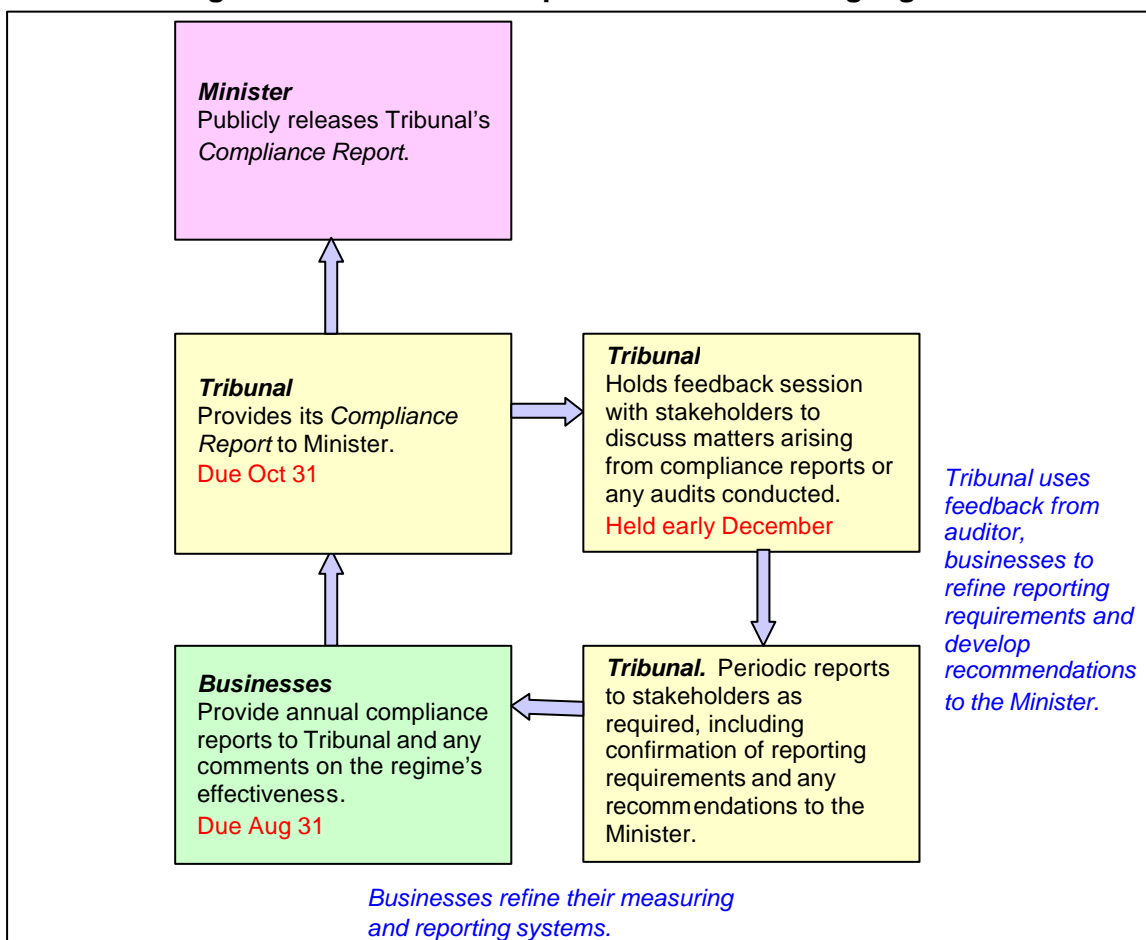
**The Tribunal will establish a process that regularly reviews and updates the regime by:**

- **refining the reporting requirements set out in the Reporting Manuals**
- **making recommendations to the Minister on changes to conditions and administrative arrangements.**

The Tribunal will use compliance reports and other feedback to develop recommendations to the Minister about changes to licence and authorisation conditions to ensure that they continue to effectively support the Government’s policy objectives. Alternatively, if the best way to address an issue is to amend the Reporting Manuals, then the Tribunal should implement the change.

To promote certainty, changes to reporting requirements should only be made according to a pre-established process. The Tribunal would use the annual cycle shown in Figure 2.1 to generate feedback on the effectiveness of the reporting requirements and licensing regime.

**Figure 2.1 Continuous improvement of licensing regime**



The Tribunal would consider the feedback and discuss any potential refinements during the annual feedback session with businesses.<sup>31</sup> Throughout each year, the Tribunal will be communicating with stakeholders via discussions with individual licensees, publishing FAQs, hosting compliance forums, and in some cases participating in the MEU policy development activities. The annual feedback session will consolidate these actions as an annual 'state of affairs' review, particularly for the benefit of stakeholders less frequently in contact with IPART.

It would then publish its recommendations to the Minister and its decisions on any refinements to the Reporting Manuals in its annual report to stakeholders (see section 2.2).

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<sup>31</sup> The feedback session could take place during a quarterly compliance forum — see section 2.2.2.





### 3 COST EFFECTIVE COMPLIANCE MONITORING

The licensing regime must be reliable and robust to ensure that it supports the Government's FRC policy objectives. Government and stakeholders should have confidence that policy objectives are in fact being achieved, and consumers should have confidence that customer protection aspects of the new competitive retail market are operating well. Likewise, businesses should have confidence that other licensees/authorisation holders are also implementing the IT systems, business procedures and customer protection mechanisms that underpin the competitive market. However, the advantages of such a regime must be balanced against its administrative costs.

The cost effectiveness of the electricity and gas licensing regime could be significantly enhanced by targeting the way in which compliance is monitored and reported to reflect the relative impacts of breaches of particular conditions, the robustness with which businesses manage their compliance obligations, and their resulting compliance performance.

This chapter describes the Tribunal's proposals in relation to compliance monitoring. The key features of the proposals are:

- recognition of businesses' internal compliance systems
- external audits of compliance systems and conditions in key policy areas
- prioritised compliance reporting (immediate, quarterly and annual reporting) depending on the likelihood and potential impact of breaches of conditions
- collaboration with other agencies including EWON
- ad hoc compliance investigations.

#### 3.1 Recognising internal compliance systems

The Tribunal wishes to recognise and reward those businesses which implement effective internal compliance systems, and which integrate these systems with their day-to-day management activities. The Tribunal believes that rewarding, and where necessary encouraging the development of robust compliance systems is the most cost-effective way to ensure energy businesses comply with the Government's energy policy objectives.

Sections 3.2, 3.3.4 and 4.3 explain how the Tribunal intends to take the adequacy of businesses' compliance systems into account in determining the frequency and scope of external audits, the frequency of compliance reporting, and the choice of appropriate action in response to a breach of conditions.

To support this approach, the Tribunal recommended in its draft report that the Minister:

- impose a new condition requiring energy businesses to have effective compliance management systems
- revoke his current guidelines on independent appraisal of electricity licensees' compliance reports (see section 5.2.2 for a detailed discussion on this).

Businesses supported these recommendations as part of the move to improve cost-effectiveness and rewarding strong compliance.<sup>32</sup> However, their support is premised on the Tribunal streamlining licensees' reporting and auditing requirements where they demonstrate effective compliance management systems.

The Tribunal has considered the issues of whether businesses should be required to implement compliance systems that comply with *Australian Standard 3806 – 1998 Compliance Programs*. Mandating compliance with AS 3806 would provide businesses with more certainty as to the type of system they should implement to satisfy the condition. However, it may unnecessarily restrict how businesses manage their compliance.

On balance, the Tribunal believes the best compromise is for the condition to require 'effective' compliance systems, and for the Tribunal to state that it regards a compliance system that meets AS 3806 as 'effective'. This leaves businesses the option of complying with AS 3806 or implementing a different system which they regard as more appropriate, while remaining effective.

The Tribunal intends to include the effectiveness of businesses' compliance systems in the scope of compliance audits.

### Recommendation 2

***The Tribunal recommends that the Minister impose a condition requiring electricity and natural gas businesses to maintain effective compliance management systems capable of managing their compliance with their electricity licence or natural gas authorisation.***

## 3.2 External audits

The Tribunal considers external audits to be a hallmark of an effective compliance monitoring framework. In the Tribunal's view, external audits are the most effective means of generating confidence in the regime because they independently assess businesses' compliance. External audits are also useful for businesses because they identify areas within the business that are working well and those that are not. For this reason, many NSW energy businesses already choose to subject themselves to external audits, regardless of their regulatory requirements.

External audits will focus on key policy areas and businesses' compliance systems. At present, this means that only businesses active in the small retail market will be audited in respect of FRC-related obligations.

This section describes the Tribunal's proposed external audit regime and considers how the audits should be conducted.

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<sup>32</sup> EnergyAustralia submission, August 2002, p 10; AGL submission, August 2002, p 10.

### 3.2.1 Audit framework

***Businesses that receive an unqualified external audit should generally not have a scheduled audit for 3 years unless compliance difficulties arise during that period.<sup>33</sup>***

On 4 December 2001, the Minister wrote to NSW energy businesses advising them that the Tribunal would audit their compliance with certain licence/authorisation conditions associated with the introduction of FRC. These audits are currently being conducted (November 2002 through to February 2003), and cover businesses active in the small retail energy market only.

These audits will be the starting point for an ongoing audit cycle, scheduled in accordance with Figure 3.1. The proposed framework rewards businesses with a strong compliance record by granting audit holidays. This approach reduces costs by tailoring and streamlining the regime, and provides an incentive for businesses to adopt robust compliance management systems.

Businesses that receive unqualified audits would generally not have another audit scheduled until one of the following trigger events occurs:

- three years elapse since the previous audit (the Tribunal considers it prudent to check at least every 3 years that businesses' compliance programs are being maintained)
- there are significant amendments to the conditions applying to the business (in which case, the business would be audited in relation to new conditions only)
- the Tribunal receives information indicating systematic, non-trivial contraventions of condition(s).

If a compliance audit report were qualified then the Tribunal would conduct a follow-up investigation to ensure the problem was addressed. Depending on the nature of the non-compliance, these might be conducted by Tribunal staff or by external auditors.

Where non-compliances indicate significant problems with a business' compliance systems, the business would be required to undergo an external audit prior to submitting its next annual compliance report to the Tribunal. The purpose of the follow-up audit would be to obtain independent assurance that the information contained in the business's annual compliance report accurately represents its true position. The auditor may also be asked to comment on how the business's compliance system or performance might be improved.

The Tribunal does not intend to audit the compliance of businesses not active in the small retail market unless their compliance is poor, or the Government introduces new conditions and seeks assurance on their successful implementation.

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<sup>33</sup> That said, businesses may be subject to an audit if the Tribunal's other compliance monitoring activities indicate that the business has contravened (or is likely to have contravened) a licence condition (see section 4.3), or significant changes in the energy market suggest further audits are necessary.

Businesses gave qualified support to the Tribunal's approach to auditing, but raised concerns about how the Tribunal would set the scope, number and timing of audits, and the potential for this to impose excessive costs.<sup>34</sup> EnergyAustralia suggested that businesses should have appeal rights in relation to decisions of the Tribunal to audit their business.<sup>35</sup>

While the majority of businesses supported the Tribunal's recommendation that the Minister revoke his guidelines on independent appraisal of electricity licensees' compliance reports,<sup>36</sup> there was concern about the potential cost of auditing.<sup>37</sup>

The ultimate cost of compliance audits will be greatly affected by businesses' compliance levels. Stronger compliance will be reflected in fewer, less detailed audits. In any event, the cost effectiveness of the regime will be greatly enhanced by the move from 'independent assessment' to audits. The compliance information generated will focus on businesses active in the small retail market only, and will provide the Minister, the Tribunal, licence/authorisation holders and other stakeholders with much greater confidence the FRC regime has been successfully implemented.

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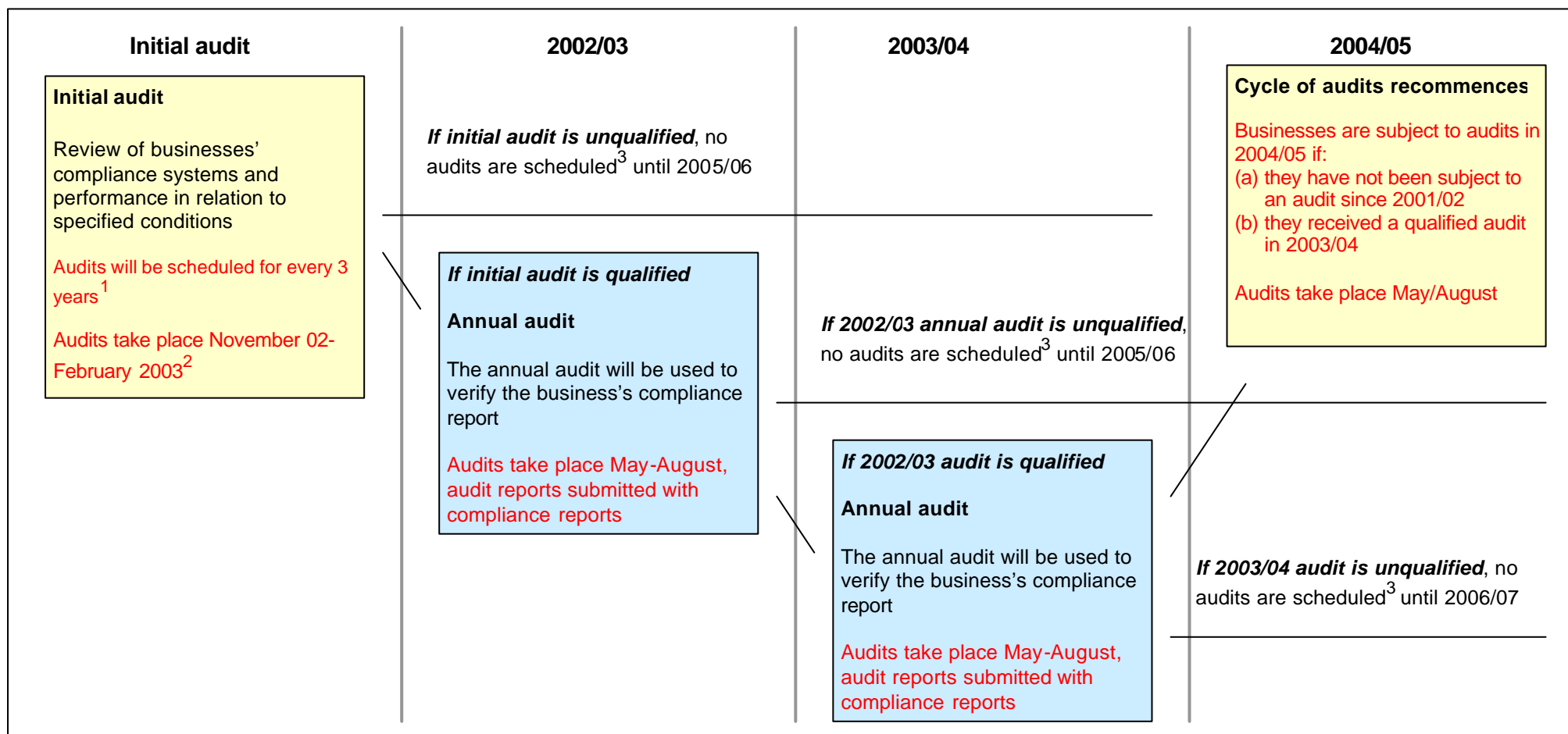
<sup>34</sup> EnergyAustralia submission, August 2002, p 14; Integral Energy submission, August 2002, p 3; AGL submission, August 2002, pp 13-17; Origin Energy submission, August 2002, p 2; Envestra submission, August 2002, pp 2-4.

<sup>35</sup> EnergyAustralia submission, August 2002, p 14.

<sup>36</sup> EnergyAustralia submission, August 2002, p 15; Integral Energy submission, August 2002, p 5; AGL submission, August 2002, p 4; Origin Energy submission, August 2002, p 3. Country Energy did not support this proposal, see Country Energy submission, August 2002, p 4.

<sup>37</sup> Integral Energy submission, August 2002, p 5.

Figure 3.1 External audit schedule<sup>1</sup>



Notes:

- 1 In addition to scheduled audits, businesses may be subject to an audit if the Tribunal's other compliance monitoring activities indicate that a business has contravened (or is likely to have contravened) a licence condition (see section 4.3).
- 2 New entrants to the small retail market will be audited soon after commencing trading. This may be done outside of the typical May to August timing.
- 3 Audits of all relevant businesses may be required if there are significant amendments to licence/authorisation conditions— such audits would be limited to the new or amended conditions.

### 3.2.2 Conduct of audits

*Type of audits*

**External audits will examine businesses' compliance systems and performance as appropriate.**

Table 3.1 describes the purpose and effect of the different types of audit.

**Table 3.1 Systems and performance audits**

	<b>Systems Audit</b>	<b>Performance Audit</b>
<b>Purpose of audit</b>	An audit of a business's compliance systems involves an examination of the systems and processes that the business has adopted in order to ensure that it complies with its obligations. <sup>38</sup> It could assess: <ul style="list-style-type: none"> <li>• the level of managerial and staff commitment to compliance</li> <li>• the extent to which the business adheres to its compliance policy<sup>39</sup></li> <li>• employees' understanding of and adherence to the businesses' compliance management systems.</li> </ul>	An audit of a business's compliance performance involves an examination of the extent to which the business complies with its licence or authorisation conditions.  A performance audit could involve the auditor forming and expressing an opinion on the reliability of information provided to the Tribunal in the business's compliance report.
<b>Effect of a qualified audit</b>	A qualified systems audit may not necessarily indicate a contravention. However, it would alert the Tribunal as to what types of contraventions it should target in its other activities, such as performance audits and complaints monitoring.	If a business receives a qualified performance audit then it is likely that it has contravened a licence or authorisation condition. In this case, the Tribunal could consider taking further action (see section 4.3).

AGL and Envestra argue that the Tribunal should limit its audits to systems audits, since these involve a degree of checking of actual compliance.<sup>40</sup> The Tribunal considers that in the first year of FRC, a combination of systems and performance audits is necessary.

Envestra suggested the Tribunal rotate its auditing of different aspects of a business over time.<sup>41</sup> The Tribunal will consider this suggestion when designing audit briefs, but hopefully most businesses will have strong compliance systems, making annual audits unnecessary.

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<sup>38</sup> The Australian standard on compliance programs, AS 3806-1998, is an example of a rigorous compliance system.

<sup>39</sup> This task could involve on-site visits, surveys and reviews of written materials and documentation. (See C Parker, "A model for the compliance professional: consulting, policing and managing" in Heller, Murphy and Meaney (eds), *A guide to professional development in compliance*, Aspen Publishers, Gaitherberg, Maryland, 2001, pp 37-53.)

<sup>40</sup> AGL submission, August 2002, p 15; Envestra submission, August 2002, p 2.

<sup>41</sup> Envestra submission, August 2002, p 4.

*Appointment of auditor*

***The Tribunal has appointed a single auditor to conduct the initial audits in 2002/03, but may consider establishing a panel of auditors (that businesses may select from) to undertake external audits in subsequent years.***

The Tribunal has considered whether compliance auditors should be engaged by the Tribunal or the businesses, and whether one or a number of auditors should be appointed to conduct the nine planned compliance audits in 2002/03. At the public workshop and subsequently in submissions to the Draft Report, electricity and gas businesses strongly supported being able to select their own auditor from a panel appointed by the Tribunal.<sup>42</sup>

For the initial audits, the Tribunal intends to audit compliance by the retailers actively marketing to small retail customers only. For this round of audits, the Tribunal believes there is great benefit in engaging one audit firm to conduct all of the planned FRC audits. Compliance system auditing is a specialised field, and the energy licensing regimes are complex and only recently implemented. The Tribunal believes one audit firm appointed by the Tribunal is the best way to manage this process for the initial audit and ensure all businesses are treated equally.

This approach is consistent with the Tribunal's conduct of what it regards as successful audits of electricity standard retailer suppliers' compliance with the Electricity Tariff Equalisation Fund Rules and water utilities' compliance with their water operating licence.

For audits in subsequent years, the Tribunal may consider whether it should establish a panel of auditors to undertake external audits.

*Scope of external audits*

***External audits will assess businesses overall compliance systems and their actual compliance with key conditions.***

***The Tribunal will consider developing a generic terms of reference for external audits in consultation with auditors, licence/authorisation holders and other stakeholders. However, the scope of external audits may also be tailored according to the compliance record of the individual business.***

For the initial FRC-related audits, the Tribunal consulted stakeholders and those businesses being audited, on the scope of the audits.

In future years, external audits will continue to focus on key policy areas, and may be further targeted to reflect each business' compliance performance. For instance, if an initial audit revealed that a business has complied with most licence conditions, but is experiencing problems in relation to customer transfers, then in the following year the business should be audited only in relation to its obligations in respect of transfers.

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<sup>42</sup> Integral Energy submission, August 2002, p 3; AGL submission, August 2002, p 16; Envestra submission, August 2002, p 5.

### 3.2.3 Coordinating external audits with other agencies or business' internal audits

***The Tribunal will investigate whether there is scope for it to coordinate its external audits with any external audits required by other agencies or with internal audits undertaken by businesses.***

Many NSW energy licence/authorisation holders also hold licences in other States, and consequently must comply with the requirements of multiple licensing regimes. Further, businesses are subject to compliance monitoring by other agencies within the NSW regulatory framework.

Submissions to the issues paper<sup>43</sup> demonstrate that many stakeholders consider consistency between jurisdictions — and reducing regulatory duplication — to be a key issue for the Tribunal's review.<sup>44</sup> The former Electricity Association of NSW recommended that the Tribunal “actively seek an increased level of consistency between States of licence conditions and other regulatory requirements on electricity retailers and distributors”.<sup>45</sup>

The Tribunal is interested in minimising the costs incurred by businesses by coordinating its compliance monitoring activities with the activities of other NSW agencies, and the activities of regulators in other jurisdictions where possible. If the Tribunal and another agency require a business to be externally audited for the same purpose, it may be possible for the agencies to act in concert and thereby reduce the number of audits that businesses are required to undertake. While Integral Energy, AGL and Origin Energy support this concept, AGL recognised that the terms of an audit brief would need to be carefully designed.<sup>46</sup>

The scope for the Tribunal to coordinate external audits is limited insofar as different licence conditions apply in different jurisdictions. However, the Tribunal believes that there may be an opportunity for multiple agencies to rely on aspects of external audits, particularly of businesses' compliance management systems.

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<sup>43</sup> IPART, *Review of Electricity Licensing Regimes in NSW — Issues Paper, DP44*, June 2001.

<sup>44</sup> See for instance the following submissions in response to *Review of Electricity and Gas Licensing Regimes in NSW — Issues Paper, DP44*, The Australian Gas Association, 10 August 2001, p 5; NSW Distribution Network and Standard Retail Service Providers, August 2001, p 13; Energex Retail, 14 August 2001 p 5; Ergon Energy, 8 August 2001; Origin Energy, 16 August 2001, p 1; Pulse Energy, 9 August 2001, p 2.

<sup>45</sup> Electricity Association of NSW, *Regulating and Licensing Electricity Distributors and Retail Suppliers in NSW for Public Policy Objectives — Towards Best Practice*, November 2000.

<sup>46</sup> Integral Energy submission, August 2002, p 3; AGL submission, August 2002, p 17; Origin Energy submission, August 2002, p 2.



Many businesses also undertake audits for their own purposes. There may be scope for businesses to reduce costs by combining their audit with the external audit required by the Tribunal. For example, gas and electricity retailer suppliers must audit their compliance with the Marketing Code of Conduct annually.<sup>47</sup> The Tribunal will cover compliance with the Marketing Code of Conduct in its initial compliance audits. Accordingly it will accept this as full satisfaction of the codes' auditing requirements for the businesses concerned.

If a business's audit had a wider scope than the Tribunal's, any results that are over and above the Tribunal's requirements would not be made available to the Tribunal. Audits could also be timed to coordinate with the business's internal requirements, provided they are conducted generally around year end between May and August.

### 3.3 Compliance reporting

Compliance reporting gives businesses an opportunity to demonstrate they are complying with conditions of their licence or authorisation. It is an important part of an effective licensing regime because it:

1. identifies areas where businesses are experiencing compliance issues
2. raises senior management awareness within the businesses by seeking periodic confirmation of compliance
3. generates public information on compliance to support stakeholders' confidence in the regime and consumers' confidence in the retail market.

The Tribunal has proposed immediate and quarterly reporting for certain conditions because the current annual reporting arrangements are too slow to withstand the demands of FRC. For example, under an annual reporting regime, a breach committed in July 2002 would not be reported to the Tribunal until August 2003. In a newly emerging competitive market, serious contraventions must be dealt with quickly and effectively if the market is to be protected from permanent distortion. If customers perceive the contestable market to be flawed, they are unlikely to venture from their regulated retail tariff. The lag involved in the reporting process creates a risk that damage can be inflicted on the contestable market before the problem is identified.

However it is also necessary to have regard to the costs associated with preparing compliance reports. Consequently the Tribunal proposes a set of targeted reporting requirements with a streamlined reporting format. The Tribunal's proposals are modelled on the reporting arrangements established by the South Australian Independent Industry Regulator.<sup>48</sup>

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<sup>47</sup> Marketing Code of Conduct para 5.2.1(b).

<sup>48</sup> South Australian Independent Industry Regulator, *Compliance Systems and Reporting Electricity Industry Guideline No.4*, 31 March 2001.

The remainder of this section sets out the detail of the Tribunal's proposals in relation to compliance reporting. It describes:

- how the Tribunal proposes to adopt a targeted approach to reporting by classifying conditions according to their reporting priority
- the framework for reporting for each type of condition
- the Tribunal's requirements in relation to immediate, quarterly and annual reports (including format and the reporting timetable)
- the scope for the reporting requirements to adjust to reflect compliance performance.

### 3.3.1 Classifying licence and authorisation conditions

***The Tribunal will prioritise compliance reporting by classifying all conditions as Type 1, 2, or 3 based on an assessment of the likelihood of a breach and the potential impact of a breach on the Government's policy objectives.***

A streamlined approach to compliance reporting will focus the Tribunal's and businesses' attention where it is most needed and improve cost-effectiveness. The Tribunal proposes that conditions be classified as:

- **Type 1 conditions — immediate notification of a contravention.**  
Classification as a Type 1 condition would be limited to those conditions where a breach would have a critical impact on the Government's policy objective(s) and where the impact of that breach increases over time if it is not rectified quickly.<sup>49</sup>
- **Type 2 conditions — notification in the next quarterly compliance report.**  
Conditions should be classified as Type 2 based on an assessment of whether:
  - (a) a breach would seriously impact the Government's policy objective
  - (b) the condition is 'new' or has not been complied with in previous years
  - (c) there is a need to raise businesses' awareness of the condition.
- **Type 3 conditions — notification in the next annual compliance report.**  
All other conditions will be classified as Type 3 conditions where the business is required to report on non-compliances in its annual report only. Certain conditions that would otherwise seem likely to be classified as Type 1 or Type 2 may be classified as Type 3 where another agency monitors compliance on a more frequent basis. For instance, the MEU actively monitors and audits DNSPs' and reticulators' compliance with safety requirements and network management requirements. These obligations are supported by licence/authorisation conditions, but frequent reporting to the Tribunal would duplicate reporting to MEU and send a confusing signal as to which agency regulates safety.

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<sup>49</sup> For example, electricity businesses would be required to notify the Tribunal immediately if the business has been suspended from the National Electricity Market. In addition, electricity standard retail suppliers and gas standard suppliers would be required to notify the Tribunal immediately if the business is unable to implement its last resort supply plan.

Businesses were generally supportive of the proposal to prioritise compliance reporting, but sought consultation on the specific classification.<sup>50</sup> The Tribunal's draft Reporting Manuals have been released for public comment. Comments are due 31 January 2003.

The Tribunal is likely to review its classifications annually as compliance issues arise and subside. Any changes to the scope of quarterly reporting will need to be introduced in time for businesses to implement any changes to their reporting systems (see section 2.3.2 in Chapter 2).

In coming years, individual businesses' compliance performance may warrant requiring them to report more or less frequently than the broad classification of reporting priority in the Reporting Manual (see sections 3.3.4 and 4.1). However, the incentive benefits of this approach need to be balanced against the benefits of certainty from a uniform reporting regime.

### 3.3.2 Reporting framework

***Licence and authorisation holders should be required to immediately contact the Tribunal if they breach a Type 1 condition, submit quarterly compliance reports in relation to Type 2 conditions and submit annual compliance reports in relation to all conditions.***

Table 3.2 explains what is involved for each of the different types of compliance reporting.

**Table 3.2 Summary of different types of reporting requirement**

	Immediate	Quarterly	Annual
<b>Role</b>	To ensure that the Tribunal is able to respond quickly to a breach	To seek early identification of breaches, to actively monitor compliance where compliance issues are likely or suspected, and to raise senior management awareness of particular conditions	To verify continued compliance where past compliance has been high, or where a lag between the breach and its discovery does not materially increase the impact of the breach
<b>Required for</b>	Type 1 conditions	Type 2 conditions	All conditions
<b>Format</b>	Telephone call and written confirmation	Signed statement accompanied by exception report	Signed statement accompanied by exception report and other reports required under licence or authorisation conditions <sup>51</sup>
<b>Sign off</b>	CEO or equivalent	CEO or equivalent	CEO & the Board
<b>Independent verification</b>	Not applicable	No independent verification required	In some circumstances, external auditor's sign off required <sup>52</sup>

<sup>50</sup> EnergyAustralia submission, August 2002, p 11; Integral Energy submission, August 2002, p 3; AGL submission, August 2002, p 17; Country Energy submission, August 2002, p 2; Origin Energy submission, August 2002, p 1; Envestra submission, August 2002, p 3.

<sup>51</sup> For example, electricity retailers must submit key performance indicators and information on greenhouse gas emissions, while natural gas retailers must submit reports on raising natural gas consumers' safety awareness.

<sup>52</sup> The Tribunal may require the annual compliance reports of businesses that received a qualified audit in the previous year to be accompanied by an external auditor's report and signed auditor's statement. Depending on the circumstances, the auditor's report might be limited to only those aspects of compliance that gave rise to concerns during the previous year.

Immediate notification would take the form of a telephone call to the Tribunal's *Director, Energy* or the *Program Manager, Energy Licensing* and a follow-up confirmation to the Tribunal's Chairman from the CEO or equivalent. The business should notify the Tribunal as soon as it is aware that a breach is likely or has occurred.<sup>53</sup>

AGL and EnergyAustralia raised concerns about the difficulty of getting a CEO to sign off immediate and quarterly reports, particularly where the CEO is not directly involved in the operations of a licensed controlled entity.<sup>54</sup> The Tribunal considers that it is important for the CEO to be advised of any major contraventions identified in these reports and a change to this proposed requirement is not supported.

AGL also argued that annual compliance reports should be signed off by the CEO only, and not by the Board. However, the Tribunal intends to continue to require Board level sign-off for annual compliance reports. It sees this level of assurance as an essential part of the move to relying on businesses' internal compliance systems wherever possible.

### 3.3.3 Quarterly and annual compliance reports

***To streamline reporting, the quarterly and annual compliance reports will take the form of exception reports.***

Attachment 3 contains templates for the Tribunal's quarterly and annual reporting formats. Each business would be required to submit a statement signed by its Chief Executive Officer (and in the case of annual reports, the Board) that the business has complied with its licence or authorisation obligations. The business would make an assessment on whether or not it has complied with each condition.

If a business has contravened a condition, it would be required to provide an exception report which details the:

- extent and nature of the non-compliance
- reasons for non-compliance
- actions taken to rectify the contravention and any subsequent harm to a customer and/or other licence holder, and to prevent it reoccurring
- anticipated timing to resolve the non-compliance.

The business would provide this information in relation to every condition that it has contravened. No reporting would be required for conditions that the business has complied with. Businesses are supportive of exception reporting<sup>55</sup> and to date the Tribunal has found it highly successful.

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<sup>53</sup> SA also requires notification "as soon as the licensee becomes aware of the event". South Australian Independent Industry Regulator, *Compliance Systems And Reporting Electricity Industry Guideline No.4*, 31 March 2001, para 3.1.5.

<sup>54</sup> EnergyAustralia submission, August 2002, p 14; AGL submission, August 2002, p 17.

<sup>55</sup> EnergyAustralia submission, August 2002, p 12; Integral Energy submission, August 2002, p 4; Origin Energy submission, August 2002, p 1; Envestra submission, August 2002, pp 2-3.

*Quarterly and annual reporting timetable*

***Businesses should be required to submit quarterly exception reports one month after the end of the quarter<sup>56</sup> and annual exception reports two months after the end of the financial year.***

On 4 December 2001, the Minister wrote to relevant gas and electricity businesses requiring that they report to the Tribunal on compliance in April and July 2002. The Minister has since extended the quarterly compliance reporting arrangements.

At present, electricity licensees are required to submit annual compliance reports, but natural gas authorisation holders are not. The Tribunal believes that gas should be brought into line with electricity. To avoid retrospectively introducing reporting, the Tribunal believes that natural gas authorisation holders should not be required to submit annual compliance reports in 2002/03.

For 2003/04 and onwards the Tribunal will request all electricity licence and natural gas authorisation holders to report in accordance with the timetable set out in Table 3.3.

**Table 3.3 Proposed reporting timetable for 2003/04 onwards**

<b>Business</b>	<b>Scope of report</b>	<b>Sign off</b>	<b>Due</b>
All businesses subject to Quarterly Reporting	Exception report on the selected conditions for July to Sept	CEO	Oct 31
All businesses subject to the Type 2 conditions	Exception report on the selected conditions for Oct to Dec	CEO	Jan 31
All businesses subject to the Type 2 conditions	Exception report on the selected conditions for Jan to March	CEO	April 30
All businesses	Exception report on all conditions during year Plus other reports as required by individual conditions	CEO & the Board Compliance audit of selected conditions unless exempt	Aug 31

Under the proposed arrangements, quarterly compliance reports would be submitted to the Tribunal one month after the end of each quarter. The Tribunal has streamlined the reporting timetable so that businesses can submit their June quarterly compliance reports as part of their annual compliance report in August.

EnergyAustralia and Integral Energy sought a longer period in which to arrange sign-off of their annual reports.<sup>57</sup> However, this is not possible if the Tribunal is to meet its statutory reporting timetable of 31 October each year. Furthermore, the move to exception reporting and the (recommended) removal of electricity licence plans and reports should make businesses' annual reporting workloads more reasonable.

<sup>56</sup> Licence or authorisation holder will not have to submit a separate June quarter compliance report, instead it will be rolled into the August annual report.

<sup>57</sup> EnergyAustralia submission, August 2002, p 12; Integral Energy submission p 4.

*Compliance issues to be addressed in the Reporting Manuals*

**Where necessary, compliance criteria that clarify what is required for satisfactory compliance will be set out in the Tribunal's Reporting Manuals.**

**Businesses will be required to state that they have assessed their compliance based on data which they are 'highly confident' reflects their actual performance.**

Exception reporting is a straightforward approach to compliance reporting, however, it may be necessary for the Tribunal to address detailed compliance issues, such as ambiguity in the meaning of conditions, required data accuracy or non-compliance 'trigger' levels for exception reports. Table 3.4 explains each issue and describes how the Tribunal proposes to address them.<sup>58</sup>

**Table 3.4 Tribunal's proposals in relation to detailed compliance issues**

<b>Issue</b>	<b>Explanation</b>	<b>Tribunal's proposed approach</b>
<b>Ambiguity in the precise requirements of conditions</b>	Sometimes there may be practical reasons why businesses are unsure whether they should submit an exception report to the Tribunal. For instance, does an accidental transfer of a customer that was rectified within say 24 hours constitute a breach?	If issues of interpretation arise, the Tribunal proposes to specify 'compliance criteria' that clarify what it regards as satisfactory compliance with the condition. Where this involves clarification of policy objectives, any compliance criteria will need to be approved by the Minister, or may need to be addressed by the Minister via amendment of a condition.
<b>Data accuracy</b>	Compliance reporting is based on performance data. For compliance reports to reflect actual outcomes, performance data needs to be accurate. Other jurisdictions explicitly specify requirements in relation to the accuracy of the data used in businesses' compliance reports.	Businesses will be required to state that they have assessed their compliance based on data which they are 'highly confident' reflects their actual performance. <sup>59</sup> More explicit data accuracy requirements could be introduced later if data accuracy is found to be inadequate.
<b>Triggers for exception reports</b>	If businesses are required to report every single contravention, there is a risk that they may need to prepare a large number of exception reports. This could potentially create a large amount of paperwork for little benefit. Other jurisdictions have adopted trigger mechanisms — if levels of non-compliance are below the specified trigger, no exception report is required.	With the experience of the first 11 months of full retail competition, the Tribunal believe that 'trigger' levels for reporting non-compliances may not yet be required. The Tribunal will reconsider this after it has received public comments on the draft Reporting Manuals.

<sup>58</sup> Part 2 of NERA's report considers each issue in detail. NERA, *Review of Energy Licensing Regimes in NSW: Compliance Monitoring and Reporting Framework*, March 2002, pp 31-39.

<sup>59</sup> In addition, external auditors would be asked to comment on the adequacy of the accuracy of the data captured by the licensee.

EnergyAustralia and AGL support including compliance criteria in the Reporting Manuals.<sup>60</sup> The Tribunal cannot override the wording of conditions, so compliance criteria can only clarify what the Tribunal regards as satisfactory compliance.

In the Draft Report the Tribunal proposed that businesses be asked to declare that they have reported their compliance relying on data which they are 'highly confident' reflects their actual performance. As an alternative to this, AGL argue that the Tribunal should rely on its compliance system audits to determine data accuracy.<sup>61</sup> In practice this would be difficult because of the irregular timing and frequency of audits.

### 3.3.4 Reporting requirements targeted to reflect compliance performance

***The Tribunal may vary the frequency of individual businesses' reporting in accordance with their compliance record.***

In future years, it may be appropriate for businesses with a strong track record of compliance to be rewarded with a reduction in their reporting obligations. For instance, the Tribunal could exempt businesses with a strong compliance record from the requirement to submit a quarterly compliance report. Instead, the exempt business would agree to notify the Tribunal when it becomes aware of a contravention (or suspected contravention).

However, all businesses would continue to make annual compliance reports. This is because reporting has a range of roles, including generating information that will promote confidence in the regime.

A business's exemption from quarterly reporting would be conditional on the outcome of the Tribunal's other compliance monitoring activities (described in sections 3.4 and 3.5). For instance, if the Tribunal found that a business was breaching conditions, then it could reinstate the business's obligation to submit quarterly compliance reports. Further, the Tribunal could require more regular reporting on particular conditions if it has concerns about a business's compliance performance.

Businesses were generally supportive of this incentive approach, with for example, EnergyAustralia recognising that greater regulatory oversight in the short term should allow for less frequent reporting by consistently compliant businesses.<sup>62</sup>

## 3.4 Collaboration with other agencies

***The Tribunal will use memoranda of understanding with other agencies to streamline businesses' reporting requirements and to learn about potential compliance issues identified by other agencies.***

The Tribunal has entered into (or intends to enter into) a memorandum of understanding (MOU) with EWON, the MEU, the Department of Fair Trading, NEMMCO and the GMC. A key function of the MOUs is to prevent reporting over-lap, ensure timely exchange of information and ensure that the monitoring of certain obligations does not 'fall through the cracks'. For instance, it is unnecessary for businesses to report to the Tribunal on whether

<sup>60</sup> EnergyAustralia submission, August 2002, p 12; AGL submission, August 2002, p 18.

<sup>61</sup> AGL submission, August 2002, p 18.

<sup>62</sup> EnergyAustralia submission, August 2002, p 12.

they complied with their obligation to be a member of EWON, because the Tribunal can obtain that information directly from EWON.

The Tribunal proposes to incorporate the benefits of information sharing into its Reporting Manuals. This gives the Tribunal access to a method of compliance monitoring that is beyond its resources acting alone, and reduces the regulatory costs imposed on businesses.

In particular, collaboration with EWON will greatly enhance the Tribunal's capacity to monitor compliance with conditions.<sup>63</sup> Customer complaints are a 'real-time' check that can be used to supplement a system of audited compliance reporting. EWON's role is to resolve individual customers' problems and refer potential breaches of conditions to the Minister. Under the MOU, EWON will also directly advise the Tribunal of potential contraventions of licence or authorisation conditions as evidenced by customer complaints.

AGL and Country Energy point out that complaints to EWON are not necessarily indicative of a breach of licence/authorisation conditions and argue that the nature of complaints to EWON must be further analysed.<sup>64</sup> The Tribunal acknowledges this, and properly investigates, in close consultation with a licensee, any compliance information referred to it by EWON.

As the Tribunal will observe procedural fairness when investigating allegations of breaches of licence or authorisation conditions, the benefits of information-sharing with other agencies outweigh the possibility that this information may be used inappropriately.

A number of businesses supported the concept of memoranda of understanding and the clarification of the roles of various agencies,<sup>65</sup> but expressed some concern about the details of these arrangements. EnergyAustralia and Integral Energy sought clarification of the nature of information to be exchanged between the Tribunal and EWON and confirmation that the confidentiality of information should be preserved when exchanged between agencies.<sup>66</sup>

The Tribunal understands that EWON has its own procedures for consulting members on any suspected compliance issues. Any concerns businesses have about confidential information are probably best addressed in the context of their existing interactions with EWON.

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<sup>63</sup> Energy businesses that deal with small customers are required to be members of an approved ombudsman scheme and abide by the decisions of the Ombudsman. (*Electricity Supply Act 1995* s96C, *Gas Supply Act 1996* s33H.) At present, EWON is the only approved ombudsman scheme. EWON is the main body for handling complaints by energy customers, including complaints that involve the contravention of a condition. (A significant proportion of conditions relate to customer protection.) EWON has the power to receive, investigate and facilitate the resolution of customer complaints against its members.

<sup>64</sup> AGL submission, August 2002, pp 12 and 19; Country Energy submission, August 2002, p 2.

<sup>65</sup> EnergyAustralia submission, August 2002, pp 8 and 13; Integral Energy submission, August 2002, p 3; AGL submission, August 2002, p 10; Country Energy submission, August 2002, p 1.

<sup>66</sup> EnergyAustralia submission, August 2002, pp 8 and 13; Integral Energy submission, August 2002, pp 3 and 13.



### 3.5 Mystery shopping

In the Draft Report, the Tribunal proposed to arrange anonymous sampling of licence and authorisation holders' compliance with relevant conditions. It was argued that 'mystery shopping' would be helpful in monitoring compliance with the marketing and customer service-related conditions imposed along with the FRC reforms.

This proposal was strongly opposed by a number of businesses, who argued that mystery shopping is unnecessarily intrusive.<sup>67</sup> AGL argued that the Tribunal should clarify what issues it will investigate and how the information obtained through mystery shopping will be used.<sup>68</sup>

Given the strong opposition to this proposal, the Tribunal will not pursue a formal program of mystery shopping. However the Tribunal may utilise some form of mystery shopping as part of an ad hoc investigation if this appears appropriate at the time.

Like customer complaints, mystery shopping is a form of 'real-time' compliance monitoring. Mystery shopping can be used reactively to better inform the Tribunal about potential problems that it has become aware of through its other compliance monitoring activities.

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<sup>67</sup> EnergyAustralia submission, August 2002, p 13; Integral Energy submission, August 2002, p 4; Envestra submission, August 2002, p 4.

<sup>68</sup> AGL submission, August 2002, p 19.



## 4 INCENTIVES TO COMPLY AND CREDIBLE ENFORCEMENT

If the Tribunal is to successfully support an industry-wide culture of compliance, it is essential to create an appropriate set of incentives. Many of the ideas already discussed provide incentives to comply. However, regulatory regimes that rely solely on incentives alone are unlikely to be effective.<sup>69</sup> An effective regime must have the capacity to respond to contraventions, as businesses' incentive to comply will be greatly diminished if the potential for sanctions is not credible.

This chapter considers how the Tribunal could carry out its enforcement functions in a transparent and responsive manner. It proposes that the Tribunal:

- clarifies the factors that will influence the Tribunal's enforcement decisions
- adopts a flexible and proportionate set of enforcement options.

### 4.1 Reporting and auditing will reflect compliance history

As indicated, the Tribunal will scale back the required compliance auditing (and potentially the frequency of reporting) if a business has implemented a strong compliance system, receives a clear compliance audit report, and demonstrates a good compliance history.

However, where businesses fail to comply with key conditions or do not implement an appropriate compliance system the Tribunal will progressively increase the extent and frequency of compliance auditing and reporting.

Similarly, the Tribunal intends to consider the effectiveness of a businesses' compliance system when assessing the appropriate response to a breach. This could be done by engaging an external auditor to review the businesses compliance system. An anomalous breach by an otherwise compliant business is likely to require a less severe response than a systematic pattern of breaches due to poor internal controls or deliberate misfeasance. This approach has been used to assess penalties for breaches of trade practices law both in Australia and the United States.<sup>70</sup>

Prompt reporting of breaches to the Tribunal and full cooperation in addressing any harm caused by the breach and removing the potential for further breaches will also be looked on favourably.

Although supportive of this incentive approach,<sup>71</sup> businesses are concerned that compliance audits might become more frequent and intrusive.<sup>72</sup> These concerns appear to arise from the potential use of auditing as a compliance enforcement mechanism. The Tribunal will address these concerns by publishing a compliance policy to outline its procedures for dealing with compliance issues, including the appropriate role for compliance audits.

<sup>69</sup> See Ayres & Braithwaite, *Responsive Regulation — Transcending the Deregulation debate*, Chapter 2, 1992.

<sup>70</sup> See, for instance *TPC v TNT Australia Pty Ltd*, 1995, ATPR 41-375, *ACCC v Australian Safeway Stores*, 1997, ATPR 41-562 and United States *Federal Court Sentencing Guidelines*.

<sup>71</sup> EnergyAustralia submission, August 2002, p 6; Integral Energy submission, August 2002, p 3; AGL submission, August 2002, p 14; Origin Energy submission, August 2002, p 2.

<sup>72</sup> EnergyAustralia submission, August 2002, p 14; AGL submission, August 2002, p 15.

## 4.2 Transparent approach to enforcement

***The Tribunal will adhere to a transparent compliance policy that details the factors that the Tribunal will take into account when deciding to take regulatory action.***

The Tribunal intends to co-operate with businesses in order to obtain satisfactory compliance outcomes. However, it is also prepared to use its statutory powers to enforce compliance with conditions where appropriate. A key failing of the previous compliance arrangements was that the regulator did not enforce conditions when it identified contraventions.<sup>73</sup> Businesses' incentives to comply will be undermined if they see non-compliant competitors go unchecked.

The Tribunal has a number of choices when deciding how to respond to a contravention of a condition. If a contravention is serious, the Tribunal should be prepared to impose a pecuniary penalty or recommend that the Minister either imposes a (larger) pecuniary penalty or cancels the business's licence and authorisation. If a contravention is less serious, the Tribunal could require the business to take corrective action or publicise the breach. It will not always be appropriate for the Tribunal to take action beyond reporting the non-compliance to the Minister. For instance, in the initial phases of full retail competition there were some inadvertent customer transfers, which were rapidly fixed.

The Tribunal intends to publish a transparent compliance policy that includes imposing penalties where appropriate. The policy will detail the factors that the Tribunal will take into account when deciding to take regulatory action, and the steps that the Tribunal will take if it believes a business has contravened conditions. The policy will document how procedural fairness is currently incorporated into the Tribunal's activities.

### 4.2.1 Factors that will influence the Tribunal's enforcement decisions

Before taking enforcement action the Tribunal must satisfy itself that action is appropriate notwithstanding:

- (a) any penalty or claim for compensation to which the business is, or may be, subject to
- (b) the substance and cost of any action the business has taken in respect of the contravention.<sup>74</sup>

The Tribunal must also consider the seriousness of the contravention when imposing a monetary penalty.<sup>75</sup> In accordance with these obligations, the Tribunal will take full account of the particular facts and circumstances when deciding on whether to take enforcement action (or what form of action it should take). It will also take full account of any representations made to it by interested parties.

However, as a matter of policy, the Tribunal will also consider the specific factors set out in Table 4.1 when considering the appropriate response to a breach of conditions.<sup>76</sup>

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<sup>73</sup> See, for instance, *Licence and authorisation Compliance Advisory Board Annual Report 1999*, p 59 and IPART, *Electricity distribution and retail licence and authorisations: compliance report for 1999/2000*, p 6.

<sup>74</sup> *Electricity Supply Act 1995* Schedule 2, cl 8A(7) and *Gas Supply Act 1996* s13A(7).

<sup>75</sup> *Electricity Supply Act 1995* Schedule 2, cl 8A(8) and *Gas Supply Act 1996* s13A(8).

<sup>76</sup> The table is adapted from the Ofgem document *Utilities Act — Statement of policy with respect to financial penalties*, April 2001.

**Table 4.1 Factors relevant to the Tribunal’s enforcement decisions**

Factors which suggest a less severe (or no) enforcement response	Factors which suggest a more severe enforcement response
<ul style="list-style-type: none"> <li>• the contravention did not have a significant detrimental effect on Government policy objectives</li> <li>• the contravention or possibility of a contravention would not have been apparent to a diligent business</li> <li>• the circumstances from which the contravention arose were outside the reasonable control of the business</li> <li>• there is evidence that the contravention was genuinely accidental or inadvertent</li> <li>• the business has taken steps to secure compliance either specifically or by maintaining a robust compliance system</li> <li>• the business has taken appropriate action to remedy the contravention including compensation where relevant</li> <li>• the business voluntarily reported the contravention to the Tribunal</li> <li>• the business has co-operated with the Tribunal’s ad hoc investigation</li> </ul>	<ul style="list-style-type: none"> <li>• the contravention has had a strong adverse effect on Government policy objectives, for instance, the contravention has damaged the interests of consumers or other market participants</li> <li>• the business derived a benefit (financial or otherwise) from the contravention</li> <li>• regulatory action is likely to create an incentive to improve compliance and deter future contraventions</li> <li>• the business continued the contravention after either becoming aware of the contravention or becoming aware of the start of the Tribunal’s ad hoc investigation</li> <li>• the business’s senior management were involved in the contravention</li> <li>• there is no evidence of internal mechanisms or procedures intended to prevent contravention</li> <li>• the business attempted to conceal the contravention from the Tribunal or other monitoring organisations, such as NEMMCO</li> </ul>

The Tribunal may decide not to take enforcement action against a business even if the business only meets some (rather than all) of the criteria set out in the left hand column.

Whilst it is important for businesses to understand which factors are likely to influence the Tribunal’s view on enforcement action, the factors listed above are not intended to be all-inclusive or binding. The Tribunal will determine an appropriate response based on all of the circumstances of the matter under consideration, which means that where appropriate, the Tribunal may take into account factors that are not encompassed by Table 4.1. The table is intended to improve transparency rather than provide a formula for enforcement decisions.

### 4.3 Enforcement options

***The Tribunal will respond to contraventions in a proportionate manner using one or more of a hierarchy of enforcement options.***

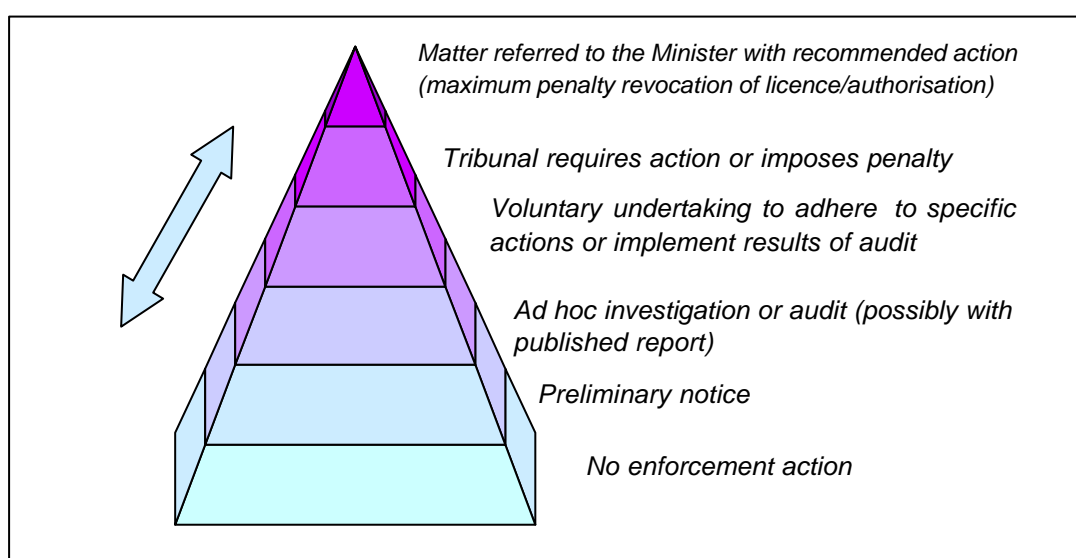
A licensing regime is most likely to be effective if there is a range of regulatory responses available to reflect the seriousness of various contraventions that may be committed. Businesses are unlikely to be deterred from contravening their conditions if the benefits stemming from the contravention exceed the maximum penalty. Conversely, a severe penalty (such as revocation of a licence or authorisation) will not be an effective deterrent on its own because businesses recognise that the enforcement agency will be unwilling to take such drastic action in the absence of a severe contravention.

When the Tribunal becomes aware of a compliance issue, its first action is to draw the issue to the attention of the business, if it is not already aware, and seek its response to the apparent facts.

If the Tribunal remained concerned about a potential non-compliance, it would select one of the tools set out in Figure 4.1. In general, the Tribunal anticipates that it would start at the bottom of the pyramid and continue to apply increasingly demanding tools until the compliance issue is resolved.

However the appropriate course of action will ultimately depend on the nature of the breach or breaches, their impact, and the business's response to the problem. In the case of very serious licence and authorisation contraventions (such as suspension from the National Electricity Market) it may be necessary for the Tribunal to take stronger action immediately. Each of the options is discussed in more detail below.

**Figure 4.1 Possible enforcement options<sup>77</sup>**



### 4.3.1 No enforcement action

Sometimes the most appropriate regulatory response may be for the Tribunal to report the contravention to the Minister<sup>78</sup> and recommend no further action. This might be because the contravention is minor, or the business has already taken action to remedy the problem.<sup>79</sup>

If the Tribunal decides to take no enforcement action in relation to a contravention, it will inform the business in writing of its decision. The Tribunal's letter would document the non-compliance and any actions that the Tribunal understands the business has already taken to rectify the breach and avoid a recurrence.

<sup>77</sup> Adapted from Ayres & Braithwaite, *Responsive regulation— Transcending the Deregulation Debate*, Oxford University Press, 1992, p 39.

<sup>78</sup> The Tribunal is required to report contraventions of conditions to the Minister under section 87(1) of the *Electricity Supply Act 1995* and section 75A(3) of the *Gas Supply Act 1996*.

<sup>79</sup> Factors that will influence the Tribunal's decision on whether or not to take enforcement action are set out in section 4.2.1.

### 4.3.2 Preliminary notice

If the Tribunal is unsatisfied with the results of its initial discussions with the business, it may decide to bring matters to a head by sending the business a formal notice that:

- requests an explanation of the apparent non-compliance
- warns the business that further regulatory action may be taken.

As well as being fair to businesses, the notice would ensure that the business was aware of the contravention.<sup>80</sup> The preliminary notice would invite the business to respond to the issues raised and set a deadline for the business's response.

### 4.3.3 Ad hoc investigations

If the Tribunal was dissatisfied with the business's response to its preliminary notice, it could undertake an ad hoc investigation. Clearly, if the damage caused by the non-compliance worsened the longer it went unresolved, the Tribunal may instigate an investigation without first sending a preliminary notice.

An ad hoc investigation could potentially take the form of an investigation by Tribunal officers, an external audit or an internal investigation by the business (the results of which are reported to the Tribunal). The ad hoc investigation would examine whether there has been a contravention, and if so, the circumstances of the contravention, including the adequacy of the investigated business's compliance procedures.

The Tribunal proposes that it conduct ad hoc investigations in accordance with the following general procedures:

1. The Tribunal would initiate an ad hoc investigation by providing notice in writing to the relevant business. The notification should detail the issue that is being investigated and any information that the Tribunal requires the business to submit. If customers or other stakeholders are affected by the breach, it may be appropriate to publicise the commencement of the investigation to put them on notice.
2. In carrying out the ad hoc investigation, the Tribunal could require the business to provide certain information to it (or to an external auditor), meet with the Tribunal's staff and/or appoint consultants or external auditors to examine the business's activities.
3. When the Tribunal has concluded its investigation, it would advise the business of its findings and if appropriate notify the public or other stakeholders of the result.

An outcome of an ad hoc investigation might be that the Tribunal forms the view that the contravention did not occur — in which case the Tribunal's findings would be outlined in its advice and where appropriate provided to customers and/or stakeholders.

If a serious contravention is found to have occurred, the business could be required to report more regularly on certain licence conditions. Alternatively, the business might agree to a voluntary undertaking with a follow-up audit or investigation.

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<sup>80</sup> Under *Electricity Supply Act 1995*, Schedule 2, cl 8A(5) and the *Gas Supply Act 1996*, s13A(5) the Tribunal may only take enforcement action against a licensee/authorisation holder if it has 'knowingly contravened' a licence/authorisation condition.

In the case of a serious contravention, the Tribunal would prepare a report to the Minister that documents its findings. These reports would briefly explain the reason for the investigation, assess the issues, and set out the Tribunal's recommendations on how the matter should be addressed (potentially including recommendations to the Minister on sanctions). In the most serious cases, the Tribunal's report could include a recommendation that the Minister impose a more substantial penalty.

In less serious cases, the Tribunal would report its findings to the Minister as part of its annual or quarterly compliance reports.

### 4.3.4 Voluntary undertakings

The Tribunal and businesses could respond to a contravention by means of a voluntary undertaking. A voluntary undertaking could potentially be an outcome of an ad hoc investigation, or the parties could simply reach an agreement without an investigation (perhaps on the basis of an internal investigation by the business).

The business and the Tribunal would agree on the actions to be taken by the business in order to remedy the contravention and establish systems and procedures to prevent the contravention from recurring. The Tribunal would agree not to take further enforcement action so long as the business complies with the voluntary undertaking. Examples of actions that might be agreed to in a voluntary undertaking include compensating customers for loss suffered as a result of the contravention, or implementing an internal compliance program with particular features. The voluntary undertaking could also include a requirement that a follow-up audit be performed.

The Tribunal would provide details of any voluntary undertaking to the Minister in accordance with its statutory obligations.<sup>81</sup> Of course, the Minister retains the powers to take further action notwithstanding any voluntary agreement between the Tribunal and the business.

### 4.3.5 Tribunal imposes penalty or requires remedial action

If the previous measures are inappropriate, or fail to restore a satisfactory level of compliance, the Tribunal may decide to take more direct enforcement action.<sup>82</sup>

If a business has knowingly<sup>83</sup> contravened a condition, the Tribunal may impose a monetary penalty or take other action the Tribunal considers appropriate.<sup>84</sup> For example, the Tribunal might require the business to send information to customers or publish notices in newspapers.

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<sup>81</sup> The Tribunal must report to the Minister on the extent to which businesses comply, or fail to comply, with licence/authorisation conditions: *Electricity Supply Act 1995*, s87(1), and *Gas Supply Act 1996*, s75A(3).

<sup>82</sup> Where a business knowingly contravenes a condition, the Tribunal may take enforcement action against the business in line with clause 8A of Schedule 2 of the *Electricity Supply Act 1995* and s13A of the *Gas Supply Act 1996*. The Tribunal must not impose a penalty if the Minister has already done so: *Electricity Supply Act 1995*, Schedule 2, cl 8A(9), *Gas Supply Act 1996* s13A(9).

<sup>83</sup> *Electricity Supply Act 1995*, Schedule 2, cl 8A(5), *Gas Supply Act 1996*, s13A(5).

<sup>84</sup> *Electricity Supply Act 1995*, Schedule 2, cl 8A(1) & (2), *Gas Supply Act 1996*, s13A(1) & (2).



The maximum monetary penalty the Tribunal may impose is \$10,000 for the first day on which each contravention occurs and a further \$1,000 for each subsequent day (not exceeding 30 days) on which the contravention continues.<sup>85</sup>

If the Tribunal requires some remedial action by the business, the cost of that action cannot exceed the value of the monetary penalty that the Tribunal could otherwise impose.<sup>86</sup> Where the Tribunal requires information to be sent to a customer, the business may satisfy that requirement by sending the information to the customer with the next account or other information scheduled to be sent to the customer.<sup>87</sup>

#### **4.3.6 Matter referred to Minister**

If the Tribunal believes that it is appropriate that the business receive a more severe penalty, it could refer the matter to the Minister. In this case the Tribunal would recommend an appropriate penalty, however, the decision rests with the Minister. The Minister may impose a monetary penalty of up to \$100,000, cancel the licence/authorisation, or both.<sup>88</sup> The Minister may impose a penalty or cancel a licence and authorisation even if the Tribunal has already taken enforcement action.<sup>89</sup>

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<sup>85</sup> *Electricity Supply Act 1995*, Schedule 2, cl 8A(6), *Gas Supply Act 1996*, s13A(6).

<sup>86</sup> *Electricity Supply Act 1995*, Schedule 2, cl 8A(3), *Gas Supply Act 1996*, s13A(3).

<sup>87</sup> *Electricity Supply Act 1995*, Schedule 2, cl 8A(4), *Gas Supply Act 1996*, s13A(4).

<sup>88</sup> *Electricity Supply Act 1995*, Schedule 2, cl 8(1), *Gas Supply Act 1996*, s13(1).

<sup>89</sup> *Electricity Supply Act 1995*, Schedule 2, cl 8A(10), *Gas Supply Act 1996*, s13A(10).



## 5 ENSURING THAT CONDITIONS REFLECT THE NEW REGIME

Just as the administrative arrangements should be updated to reflect Government's new policy, the licence and authorisation conditions themselves should align so that the licensing regime is consistent and coherent.

Most licence or authorisation conditions reflect current Government energy policy, having been imposed or amended in recent changes to legislation,<sup>90</sup> regulations<sup>91</sup> or subsidiary legal instruments such as market operations rules. However some conditions imposed by the Minister predate the introduction of FRC. Some of these pre-FRC conditions are now redundant, while others remain relevant to a particular Government energy policy.

This chapter identifies those Ministerially-imposed electricity conditions that the Tribunal recommends should be removed and outlines why others continue to be relevant. The Tribunal and the MEU have jointly reviewed the pre-FRC, Ministerially-imposed natural gas conditions. The Minister has consulted stakeholders on proposed changes to authorisation conditions and will inform authorisation holders of the changes when they have been finalised.

In addition, this chapter summarises the new electricity and natural gas conditions needed to allow the Tribunal to implement its proposed approach to administering the energy licensing regime.

EnergyAustralia and AGL argue that a more comprehensive review of licence and authorisation conditions is required, including FRC-related conditions.<sup>92</sup> The Tribunal believes that it is not appropriate to review FRC-related conditions at this time as they clearly reflect current Government policy and businesses are still in the process of fully implementing systems to ensure their compliance.

### 5.1 New conditions to support the Tribunal's preferred approach

To allow the Tribunal to administer electricity and natural gas licensing on a common footing, the Tribunal has recommended new conditions requiring:

- natural gas businesses to comply with audits of their compliance (see page 20)
- electricity businesses to report in accordance with Reporting Manuals (see page 9)
- all businesses to maintain effective compliance management systems (see page 19).

In addition the Tribunal believes that the regimes can be further streamlined by a new condition requiring energy businesses to report in accordance with operating statistics set by the Minister.

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<sup>90</sup> See the *Electricity Supply Amendment Act 2000* which amended the *Electricity Supply Act 1995* and *Gas Supply Amendment (Retail Competition) Act 2001* which amended the *Gas Supply Act 1996*.

<sup>91</sup> See *Electricity Supply (General) Regulation 2001* and *Gas Supply (Natural Gas Retail Competition) Regulation 2001*.

<sup>92</sup> EnergyAustralia submission, August 2002, pp 15-16; AGL submission, August 2002, p 3.

Electricity businesses currently report certain operating statistics, however there is no specific licence condition requiring this. Currently the obligation is embedded in the electricity licence annual compliance reporting guidelines, which the Tribunal recommends be replaced with Reporting Manuals. Natural gas businesses report annually on a range of statistical information, but this is on a voluntary basis.

In November 2000, the Utility Regulators Forum agreed that jurisdictional economic regulators would develop a core set of nationally consistent performance reporting requirements covering the electricity industry. A Steering Committee on National Regulatory Reporting Requirements (SCRRR) was established, which has developed a set of proposals for the nationally consistent reporting of performance indicators. Most of the SCRRR's proposed KPIs are very similar to the operating statistics reported in NSW for 2001/02 under the Minister's electricity compliance reporting guidelines.

For future years, the Tribunal believes that the Minister should impose a specific condition that requires electricity and natural gas businesses to report statistical information as requested.

Businesses continue to seek clarification of the policy rationales behind collecting the currently reported information. This is an issue for Government, and the Tribunal's proposal relates to the administration of the currently required operating statistics only.

### Recommendation 3

***The Tribunal recommends that the Minister impose a condition requiring electricity and natural gas businesses to report operating statistics as specified by the Minister.***

## 5.2 Pre-FRC electricity conditions that should be removed

The Tribunal believes that the cost-effectiveness of the electricity licensing regime could be improved by removing redundant electricity licence conditions relating to:

- licence plans and reports (remove from retail and DNSP licences)<sup>93</sup>
- independent appraisal of compliance reports (remove from retail and DNSP)<sup>94</sup>
- provision of information about customer supply contracts (remove retail, retain DNSP)<sup>95</sup>
- provision of supply services to exempt persons (remove retail, retain DNSP).<sup>96</sup>

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<sup>93</sup> Conditions 3.7 and 3.8 of electricity DNSPs' and Retail Suppliers' licences.

<sup>94</sup> The obligation to have compliance reports independently appraised would be removed by revoking the Minister's guideline, Minister for Energy, *Guidelines for Independent Appraisal of Electricity Distribution Network Service Providers' and Retail Suppliers' Licence Condition Compliance Annual Reports*, June 2001.

<sup>95</sup> Condition 3.5.3 of electricity DNSPs' and Retail Suppliers' licences. Condition 3.5.2 of both licences should also be deleted as it duplicates the obligation under Sections 23(4) - DNSPs & 38A(5) - Retail Suppliers, that negotiated connection and supply contracts comply with the Act and Regulations. Condition 3.5.1 of both licences should be retained as discussed in section 5.3.5.

<sup>96</sup> Condition 3.6 of electricity DNSPs' and Retail Suppliers' licences.

### **5.2.1 Licence plans and reports (Conditions 3.7 and 3.8)**

Under the pre-FRC regime, licence plans were the primary vehicle by which Government sought to encourage electricity businesses to self-regulate their activities in key policy areas. DNSPs and retail suppliers submit licence plans every two years and report annually on their progress against the plans. Table 5.1 lists the policy areas electricity DNSPs must address in their licence plans and describes how these policy areas are now covered by other aspects of the regulatory regime.

**Table 5.1 Redundancy of electricity DNSP licence plans**

Policy area	Licence plan must address ...	Now covered in new regime by ...
Safety	<p>"A risk management strategy for:</p> <ul style="list-style-type: none"> <li>the protection of persons (and their property) affected by the DNSP's operations</li> <li>the ongoing audit and management of electrical contractors working on the DNSP's network."</li> </ul>	<p>Under the <i>Electricity Supply (Safety Plans) Regulation</i>, DNSPs must submit:</p> <ul style="list-style-type: none"> <li>Safety and Operating Plans</li> <li>Customer safety installation plans</li> <li>Public electrical safety awareness plans</li> </ul> <p>The first two of these plans must specifically address contractors working on the DNSP's network.</p> <p>The MEU audits these plans and DNSPs' safety performance. The results are publicly reported in its Network Management Report.</p>
Standards of Service	<p>"...setting, achieving and reviewing cost effective standards of service (including measurable targets) for the performance of services provided to customers ..."</p> <p>In practice, businesses report on non-standard measures and set targets in line with their historic performance.</p>	<p>In the 2004 electricity network determination, the Tribunal intends to consider explicitly incorporating standards and an incentive factor.</p>
Complaint management	<p>"...the responsive management of enquiries and complaints ..."</p>	<p>DNSPs must comply with Australian Standard 4269-1995 (Complaints handling) when reviewing, at the request of a small retail customer, a decision made pursuant to a connection contract.<sup>97</sup></p> <p>DNSPs must be members of and be bound by decisions of EWON.<sup>98</sup></p>
Compliance management	<p>"...the adoption and implementation of a strategy based on quality management principles to ensure compliance with licence conditions."</p>	<p>The Tribunal will:</p> <ul style="list-style-type: none"> <li>audit compliance management systems</li> <li>tailor auditing and reporting to reflect the adequacy of those systems</li> <li>recommend a condition requiring businesses to implement effective compliance management systems.</li> </ul>
Contribution to industry standards, guidelines and codes	<p>the adoption and implementation of a strategy for:</p> <ul style="list-style-type: none"> <li>participation in the development of industry codes of practice</li> <li>determination of the extent to which it will adopt those codes or not.</li> </ul>	<p>The <i>Electricity Supply (Safety Plans) Regulation</i> makes it mandatory for DNSPs to consider relevant electricity network industry codes when preparing plans under the regulation. The MEU regulates and reports on DNSPs' compliance in this area.</p>

<sup>97</sup> *Electricity Supply Act 1995*, Section 96 (2) and *Electricity Supply (General) Regulation 2001*, Section 49.

<sup>98</sup> *Electricity Supply Act 1995*, Section 96C.

Similarly, Table 5.2 lists the policy areas that electricity retail suppliers must address in their licence plans and describes how these policy areas are now covered in the regulatory regime.

**Table 5.2 Redundancy of electricity retail licence plans**

Policy area	Licence plan must address ...	Now covered in new regime by ...
Service standards	<p>“...setting, achieving and reviewing cost effective standards of service (including measurable targets) for retail customers...”</p> <p>In practice, businesses report on non-standard measures and set targets in line with their historic performance.</p>	<p>All customers now have access to the competitive retail market.</p> <p>Retailers report standard key performance indicators which can be benchmarked against other jurisdictions.</p> <p>At the end of the current retail determination (2004) the Tribunal can reassess whether minimum and/or target service standards are appropriate for standard supply to small retail customers.</p>
Complaint management	<p>“...the responsive management of enquiries and complaints received from customers.”</p>	<p>Retailers must comply with Australian Standard 4269-1995 (Complaints handling) when reviewing, at the request of a small retail customer, decisions made:</p> <ul style="list-style-type: none"> <li>• pursuant to a supply contract<sup>99</sup></li> <li>• arising from electricity marketing by the supplier or its agent<sup>100</sup></li> </ul> <p>Retailers supplying to small retail customers must belong to EWON.<sup>101</sup></p>
Compliance management	<p>“...the adoption and implementation of a strategy based on quality management principles to ensure compliance with licence conditions.”</p>	<p>The Tribunal will:</p> <ul style="list-style-type: none"> <li>• audit compliance management systems</li> <li>• tailor auditing and reporting to reflect the adequacy of those systems</li> <li>• recommend a condition requiring businesses to implement effective compliance management systems.</li> </ul>
Contribution to industry standards, guidelines and codes	<p>the adoption and implementation of a strategy for:</p> <ul style="list-style-type: none"> <li>• participation in the development of industry codes of practice</li> <li>• determination of the extent to which it will adopt those codes or not.</li> </ul>	<p>To support FRC, the Government has introduced detailed and prescriptive licence obligations. Voluntary codes on, for example, ‘retailer of last resort’ and customer transfers have been replaced by comprehensive, mandatory market operations rules.</p>

<sup>99</sup> *Electricity Supply Act 1995*, Section 96 (1) and *Electricity Supply (General) Regulation 2001*, Section 49.

<sup>100</sup> *Electricity Supply Act 1995*, Section 96 (2) and *Electricity Supply (General) Regulation 2001*, Sections 46 & 49.

<sup>101</sup> *Electricity Supply Act 1995*, Section 96C.

Neither the Tribunal nor the Minister has the power to approve or reject licence plans. Businesses comply with the condition provided they submit a plan and report. Licensees set their own performance targets, which they may vary at any time prior to reporting their performance. This information is not required under the revised regulatory regime and the reporting arrangements recommended by the Tribunal.

Businesses strongly support the recommendation to revoke licence Conditions 3.7 and 3.8, which require DNSPs and electricity retailers to submit and report against licence plans.<sup>102</sup>

### Recommendation 4

***The Tribunal recommends that the Minister revoke electricity DNSP and retail licence Conditions 3.7 and 3.8, which require licensees to submit and report against licence plans, as the relevant policy areas are covered elsewhere in the regulatory regime.***

### 5.2.2 Independent appraisal

Electricity licensees' annual compliance reports must include an independent appraisal of the integrity of:

- (a) the information presented in the report, and
- (b) the information relied on in planning, selection of strategies and in reporting in relation to plans required to be prepared and submitted

by an independent person qualified to make it.<sup>103</sup>

The process for selecting an independent appraiser is set out in the Minister for Energy's *Guidelines for Independent Appraisal*. The Minister and Tribunal have no say in who is appointed as the independent appraiser. Rather, the guidelines require the appraiser to have experience in:

- quality assurance, including operational or compliance auditing
- science or engineering, asset management, information systems and customer service
- the electricity industry.

and that the licensee consider how to minimise any actual or perceived conflict of interest.

The Tribunal believes that independent appraisal of licensees' compliance reports is not sufficiently rigorous to allow it to rely upon independent appraisers' reports as the only source of independent assurance. It is also not sufficiently targeted, as all conditions must be independently appraised each year. In practice, some licensees take independent appraisal very seriously and provide a comprehensive report, while others provide the absolute minimum required. The inconsistency of the reports undermines the value of the independent appraisal process.

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<sup>102</sup> EnergyAustralia submission, August 2002, p 15; Integral Energy submission, August 2002, p 2; AGL submission, August 2002, p 4; Country Energy submission, August 2002, pp 3-4; Origin Energy submission, August 2002, p 3.

<sup>103</sup> Ministerial Guidelines and Requirements Policy, boxed para 5.4.1. Refer also to footnote 94.



For 2002/03 onwards, the Tribunal intends that its auditing framework replace independent appraisal. External audits will focus on conditions where a breach is more likely or 'critical', but will also be tailored to reflect the adequacy of individual businesses' compliance management systems.

Businesses strongly support the Tribunal's recommendation that the Minister revoke his guidelines on independent appraisal of electricity licensees' compliance reports.<sup>104</sup>

### Recommendation 5

***The Tribunal recommends that the Minister revoke, for the 2002/03 reporting year and thereafter, his guidelines on independent appraisal of electricity licensees' compliance reports as auditing of compliance is adequately dealt with in the Tribunal's compliance auditing framework.***

#### 5.2.3 Providing information on supply contracts (Retail Condition 3.5.3)

Retail supplier's licence Condition 3.5.3 requires that, before entering into a negotiated customer supply contract with any franchise customers, retail suppliers must:

- (a) disclose in writing that the customer is entitled to a standard form customer supply contract with the retail supplier under Part 4 Division 2 of the Act and
- (b) provide that customer, upon request, with a copy of the standard form customer contract relevant to that customer.

Under FRC there are no franchise customers. Further, the Marketing Code of Conduct now requires retailers and marketers to obtain customers' written acknowledgement<sup>105</sup> that they have received a list of relevant information,<sup>106</sup> including:

...the small retail customer's right to an applicable standard form contract and how the terms of the offered [negotiated] supply arrangement (including all costs), differ from any applicable standard form contract.

### Recommendation 6

***The Tribunal recommends that the Minister remove Retail licence Condition 3.5.3 as the Marketing Code of Conduct requires disclosure of more extensive and useful information to small retail customers.***

Businesses showed strong support for this recommendation.<sup>107</sup>

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<sup>104</sup> EnergyAustralia submission, August 2002, p 15; Integral Energy submission, August 2002, p 2; AGL submission, August 2002, p 4; Origin Energy submission, August 2002, p 3.

<sup>105</sup> Energy Marketing Code of Conduct, para 7.1.1.

<sup>106</sup> Energy Marketing Code of Conduct, para 7.1.7.

<sup>107</sup> EnergyAustralia submission, August 2002, p 15; Integral Energy submission, August 2002, p 2; AGL submission, August 2002, p 4; Country Energy submission, August 2002, pp 3-4; Origin Energy submission, August 2002, p 3.

DNSPs' licence Condition 3.5.3, while in similar terms to the retail, remains relevant as the marketing of connection arrangements is not covered in the Marketing Code.

#### 5.2.4 Provision of supply services to exempt persons (Retail Condition 3.6)

Condition 3.6 of electricity retail licences purports to require retailers to impose certain contractual conditions in their contracts with 'exempt persons'. Exempt persons are persons such as caravan park operators and shopping centres, who are permitted to on-supply electricity to their tenants without holding their own licence.

The apparent purpose of this condition is to ensure that:

1. retailers, where necessary, require the exempt person to assist the retailer in complying with the National Electricity Code and conditions of the retailer's licence
2. exempt persons contract with non-contestable (franchise) tenants on the same terms as the customer would receive if it were connected to the local distributor's network
3. retailers approve the terms upon which exempt persons (landlords) contract with contestable (non-franchise) tenants.

Compliance with the latter two parts of this retail condition has been officially 'suspended' since 1997 with no apparent ill effect.<sup>108</sup> Further, part 2 of the condition appears redundant as all small retail tenants now have access to the EWON,<sup>109</sup> and, if they are separately metered, to the contestable market and aspects of the customer protection regulation.<sup>110</sup>

The Tribunal believes the (technically still binding) first part of the condition should also be removed, as is not aware of any retailer citing actions or inactions by exempt persons as contributing to its non-compliance with its licence or the Code.

#### Recommendation 7

***The Tribunal recommends that the Minister revoke electricity retail licence Condition 3.6, relating to supply to 'exempt persons' (landlords), as customers (tenants) of exempt persons have recourse to the EWON and, if separately metered, access to the contestable market.***

While strong support for this recommendation was shown by businesses, the Public Interest Advocacy Centre (PIAC) sought clarification of any impact on customers in residential parks.<sup>111</sup>

Exempt supply of electricity has been addressed by the MEU in a recent consultation paper.<sup>112</sup> Given the importance of this policy area, the Minister may wish to consider the Tribunal's recommendation in the context of this broader policy work being undertaken by the MEU.

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<sup>108</sup> In June 1997 the Director-General of the (then) Department of Energy wrote, with the concurrence of the Minister, to all licensed retail suppliers permitting them to not comply with sub-clause 3.6.2(b) of the condition pending a review of exemptions under the Act.

<sup>109</sup> *Electricity Supply (General) Regulation 2001*, cl 50(1)(b).

<sup>110</sup> *Electricity Supply (General) Regulation 2001*, cl 71.

<sup>111</sup> PIAC submission, August 2002, p 2.

<sup>112</sup> Ministry of Energy and Utilities, op. cit.

DNSP Condition 3.6 deals with connection of 'exempt persons' to the DNSP's network. As this condition deals exclusively with safety-related issues, the Tribunal has asked the MEU to review its continued relevance.

Further, Conditions 3.10 (specifying that the licence term is not limited) and 3.11 (expressly incorporating new statutory conditions into the licence) are unnecessary, but their continued existence does not cause any problems.

### 5.3 Pre-FRC electricity conditions that should be retained

Some pre-FRC electricity conditions should be retained<sup>113</sup> as they continue to address relevant Government policy objectives. These include conditions addressing:

- **Demand Management (Condition 3.1)**<sup>114</sup>
  - DNSPs must investigate demand management alternatives before augmenting their networks, and report in accordance with the Demand Management Code.<sup>115</sup>
- **NEMMCO Registration (Conditions 3.2 and 3.3)**
  - Retailers and DNSPs to maintain registration with NEMMCO and meet NEMMCO's technical and prudential requirements.<sup>116</sup>
- **Ring fencing (Condition 3.4)**<sup>117</sup>
  - If required by the Minister, retailers would have to separate their franchise supply affairs and keep separate accounting and business records.<sup>118</sup>
  - DNSPs must separate their distribution system operation affairs and comply with the Tribunal's Accounting Separate Code of Conduct.<sup>119</sup>
- **Standard form contracts (Condition 3.5.1)**
  - Retailers and DNSPs ensure their standard form contracts comply with the requirements of the *Electricity Supply Act 1995* and Regulations.<sup>120</sup>
- **Compliance reporting (Condition 3.9)**
  - Retailers and DNSPs to report on their compliance with licence conditions.<sup>121</sup>
- **Licence fees (Condition 3.12)**
  - Retailers and DNSPs must pay licence fees as determined by the Minister.<sup>122</sup>

<sup>113</sup> In some cases, amendment to the wording of these conditions is necessary to update them for the new FRC regime, or, as in the case of greenhouse requirements, the Government has already decided to amend the conditions in the near future. These are explained in context in this section.

<sup>114</sup> Retailer Suppliers' Condition 3.1 was removed on 1 January 2003 by the *Electricity Supply Amendment (Greenhouse Gas Emission Reduction) Act 2002 No 122*, which introduces new retail suppliers' licence obligations in relation to greenhouse gas abatement.

<sup>115</sup> Condition 3.1 of electricity DNSPs' licences.

<sup>116</sup> Conditions 3.2 and 3.3 of electricity DNSPs' and Retail Suppliers' licences.

<sup>117</sup> In December 2002, The Tribunal recommended to the Minister that he impose a new licence condition on DNSPs requiring them to comply with Ring-fencing guidelines developed by the Tribunal as jurisdictional regulator under clause 6.20(2)(b) of the National Electricity Code.

<sup>118</sup> Condition 3.4 of electricity Retail Suppliers' licences.

<sup>119</sup> Condition 3.4 of electricity DNSPs' licences.

<sup>120</sup> Condition 3.5.1 of electricity DNSPs' and Retail Suppliers' licences.

<sup>121</sup> Condition 3.9 of electricity DNSPs' and Retail Suppliers' licences.

<sup>122</sup> Condition 3.12 of electricity DNSPs' and Retail Suppliers' licences.

### 5.3.1 Demand management investigations by DNSPs (DNSP Condition 3.1)

Before expanding their distribution networks, DNSPs must investigate whether they can postpone or avoid the expansion by managing the demand for electricity. In making this assessment DNSPs consider a Demand Management Code developed by the MEU and industry.<sup>123</sup> DNSPs report annually to the MEU on a range of network management issues including demand management.

At the request of the Premier, the Tribunal conducted a public review on the *Role of demand management and other options in the provision of energy services*. The Tribunal has recently released its final report, which supports the Demand Management Code and the continuation of this condition in its current form.<sup>124</sup> The condition cannot be amended without amending the *Electricity Supply Act 1995*.<sup>125</sup>

### 5.3.2 Greenhouse gas reporting by retail suppliers (Retail Condition 3.1)

Retail Suppliers' condition 3.1 was removed on 1 January 2003 by the *Electricity Supply Amendment (Greenhouse Gas Emission Reduction) Act 2002 No 122*. This Act establishes a new greenhouse gas abatement scheme, which the Tribunal will administer. Details of the new scheme and the obligations it imposes on retail suppliers and other parties are available from [www.greenhousegas.nsw.gov.au](http://www.greenhousegas.nsw.gov.au).

### 5.3.3 NEMMCO registration and prudential requirements (Conditions 3.2 and 3.3)

DNSPs and Retail Suppliers must be registered with the National Electricity Market Management Company (NEMMCO) and must continue to meet NEMMCO's technical and prudential requirements.<sup>126</sup>

Registration with NEMMCO is a central element of the regulatory regime, being the key instrument by which NEMMCO manages businesses' interactions in the national market. NEMMCO actively enforces its prudential requirements, which require businesses to maintain bank guarantees in favour of NEMMCO for a proportion of the pool's exposure to the business.

### 5.3.4 Ring fencing (Condition 3.4)

The Minister has never activated the obligation on retailers to separate their franchise supply affairs, and with the introduction of FRC there are no longer any franchise customers. However, separation of contestable and standard supply remains an issue for standard retail supply to small retail customers. Retail ring fencing guidelines may be required at a later date if Government elects to continue to regulate retail tariffs for standard electricity supply beyond 2004.

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<sup>123</sup> Ministry of Energy and Utilities, *NSW Code of Practice Demand Management for Electricity Distributors*, May 2001.

<sup>124</sup> IPART, *Inquiry into the Role of Demand Management and Other Options in the Provision of Energy Services – Final Report*, Rev02-2, October 2002.

<sup>125</sup> See Section 6(5) of Schedule 2 to the *Electricity Supply Act 1995*.

<sup>126</sup> Condition 3.2 of electricity DNSPs' and Retail Suppliers' licences.

The Tribunal's Accounting Separation Code of Conduct is enforced under the Minister's Guidelines and Requirements Policy, which in turn relies on DNSP Condition 3.4.

In addition, the Tribunal has prepared ring fencing guidelines to address ring fencing of DNSPs' contestable services. The Tribunal has recently asked the Minister to impose a new licence condition on DNSPs relating to the ring fencing of contestable services.

### 5.3.5 Standard form contracts to comply with the Act (Condition 3.5.1)

The *Electricity Supply (General) Regulation 2001* makes it compulsory for DNSPs' and Retailers' negotiated contracts to comply with the Act and Regulations. However, there is no similar statutory provision for standard form contracts. Accordingly, the Ministerial condition requiring DNSPs and Retailers to "comply with all the provisions of the Act and Regulations under the Act concerning the making, the content and effect of standard form ... contracts" continues to be required.<sup>127</sup>

### 5.3.6 Reporting on compliance with licence conditions (Condition 3.9)

DNSPs and Retailers must provide to the Minister information he requests to demonstrate they are complying with conditions of their licences. While the Minister currently requires annual compliance reports only, the condition allows him to request further compliance-related information at any time.<sup>128</sup>

The Tribunal has recommended that the Minister impose a new condition requiring licence holders to report in accordance with Reporting Manuals established by the Tribunal (see Section 2.1.2). However, Condition 3.9 will still be required to allow the Minister or the Tribunal to investigate any apparent breaches which arise.

## 5.4 Changes to pre-FRC natural gas conditions

***The Tribunal and the Ministry of Energy and Utilities will continue to work together to standardise natural gas authorisation conditions. The Minister has consulted stakeholders on the proposed changes and will notify authorisation holders when the standard conditions have been finalised.***

Unlike electricity conditions, most pre-FRC natural gas conditions are not standard across authorisation holders. Typically these differences in these Ministerially-imposed conditions are hang overs from the transition to the current *Gas Supply Act 1996*, or from other business-specific issues that are being since resolved. By contrast, the new conditions imposed by legislation to facilitate FRC are standard across all authorisation holders.

The Tribunal favours standardising or removing the pre-FRC natural gas conditions wherever possible to make the regime easier to understand and administer. Standard natural gas retail conditions will also further improve the convergence of electricity and gas retail regulation.

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<sup>127</sup> Condition 3.5.1 of electricity DNSPs' and Retail Suppliers' licences.

<sup>128</sup> Condition 3.9 of electricity DNSPs' and Retail Suppliers' licences.

The Tribunal and the MEU are working together to standardise and update the natural gas authorisation conditions. This project will streamline or remove many of the Ministerially-imposed authorisation conditions. The Minister has consulted stakeholders on the proposed changes and will notify authorisation holders when the standard conditions have been finalised.

### **5.5 Liquefied petroleum gas licences**

The Tribunal's terms of reference include assessing the extent to which liquefied petroleum gas (LPG) licence conditions should be amended to ensure LPG distributors comply with the Government's energy policies.

LPG businesses already operate in competitive fuel markets and are thus not part of the Government's FRC reforms. Many other jurisdictions do not separately license LPG businesses, instead relying on generally-applicable legislation or regulations to regulate their safety. The Tribunal believes that safety regulation is the key policy area relevant to LPG businesses and that LPG licence conditions covering other policy areas are of little relevance to current Government policies.

During 2002 the MEU reviewed its regulation of gas network businesses, including LPG networks. This review has been completed, resulting in the introduction of the *Gas Supply (Network Safety Management) Regulation 2002*.

With the introduction of this regulation, the Tribunal does not believe there is a continued need to regulate (via licence conditions) LPG distributors' network safety or any other matter. The Tribunal recommends that the Minister remove the requirement for LPG distributors to be licensed.

## ATTACHMENT 1 TERMS OF REFERENCE

### A1.1 Review of Electricity and Gas Licensing Regimes in NSW

1. The Independent Pricing and Regulatory Tribunal (IPART) is requested, under section 9(1)(b) of the *Independent Pricing and Regulatory Tribunal Act 1992*, to:
  - (a) review the licensing regimes with regard to improved compliance with existing Government policy for electricity distributors and retail suppliers, natural gas reticulators and suppliers, and other gas distributors in NSW; and
  - (b) recommend to the Minister for Energy any changes to the administrative arrangements, or conditions, required to ensure improved compliance with existing Government policy and objectives.
  
2. In conducting the review and developing recommendations, IPART is to:
  - (a) consult with Government, the energy industry, energy customers and other relevant stakeholders;
  - (b) have regard to reviews previously carried out by the Ministry of Energy and Utilities on improving the administration of the licensing regimes in NSW; and
  - (c) ensure that any recommendations are consistent with:
    - (i) existing Government policy and objectives of the licensing regimes and regulation of energy businesses;
    - (ii) the introduction of full retail competition in gas and electricity markets;
    - (iii) the regulation of national electricity and gas markets; and
    - (iv) minimising compliance costs.
  
3. IPART must provide to the Minister for Energy an interim report on the outcomes of the stakeholder consultation by December 2001 and a final report by May 2002.





## ATTACHMENT 2 A CULTURE OF COMPLIANCE TO SUPPORT FRC

### A2.1 FRC creates the need for a culture of compliance

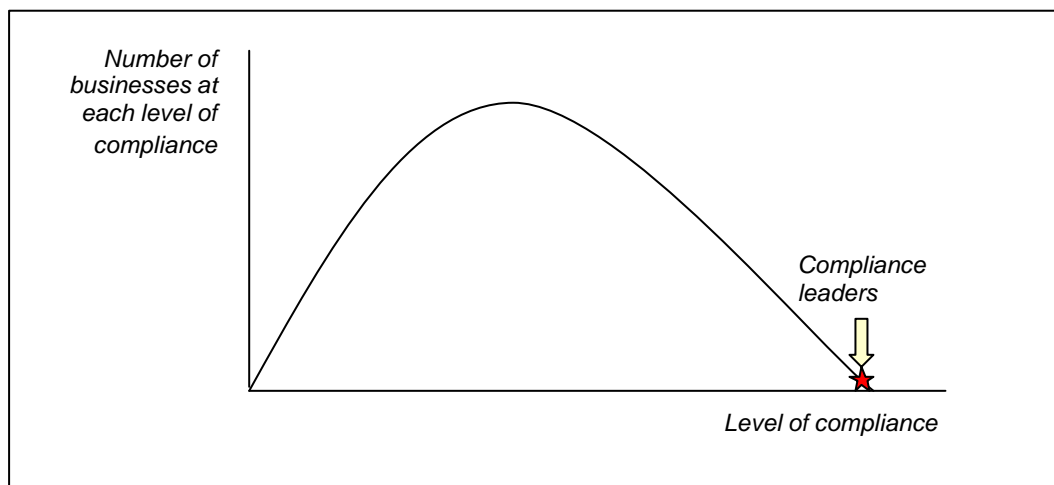
Traditionally, regulators and policy makers have approached compliance from the perspective that businesses will comply with rules if it is in their interest to do so. Therefore, so long as the consequences of a contravention are likely to be more costly than complying with the rule, businesses will comply. This view suggests that the regulator should focus on monitoring and enforcement to maximise the level of compliance.

However, non-compliance is not simply the result of businesses' cost-benefit analyses. Businesses may want to comply but find that they cannot because they don't understand their obligations, or because the rules themselves are difficult to comply with. OECD research indicates that licensed businesses may fail to comply because they:

1. don't know of, or do not comprehend, the rules
2. are unwilling to comply with the rules
3. are unable to comply with the rules.<sup>129</sup>

The level of compliance for each business will depend on how it is affected by these factors. Figure A2.1 shows how the level of compliance will vary within a regulatory target group.<sup>130</sup> Some will have a very strong record of compliance, some will have a poor record and most will be somewhere in between. The electricity regime's system of licence plans provides an excellent example of how a spectrum of compliance arises. Businesses are able to set their own performance targets, and inevitably some businesses set more challenging targets than others.

**Figure A2.1 Spectrum of compliance**



<sup>129</sup> OECD, *Improving Regulatory Compliance: Strategies and Practical Applications in OECD Countries*, 1993.

<sup>130</sup> The ideas in this section that relate to a 'spectrum of compliance' are derived from C Parker, *The Open Corporation: Effective Self-Regulation and Democracy* Cambridge, University Press, Melbourne, 2002.

In the initial stages of FRC, the level of compliance among NSW energy businesses is likely to be strongly influenced by the extent to which they are aware of and are able to comply with the new rules. Businesses have had to implement a large number of complex new systems and procedures, and it will take time for them to have everything running smoothly in the new environment.

Full retail competition has also caused a number of new participants to enter the market. It is reasonable to expect that some businesses will find it difficult to comply with all conditions in the initial stages of competition. There will be a spectrum of compliance as some businesses will perform better than others.

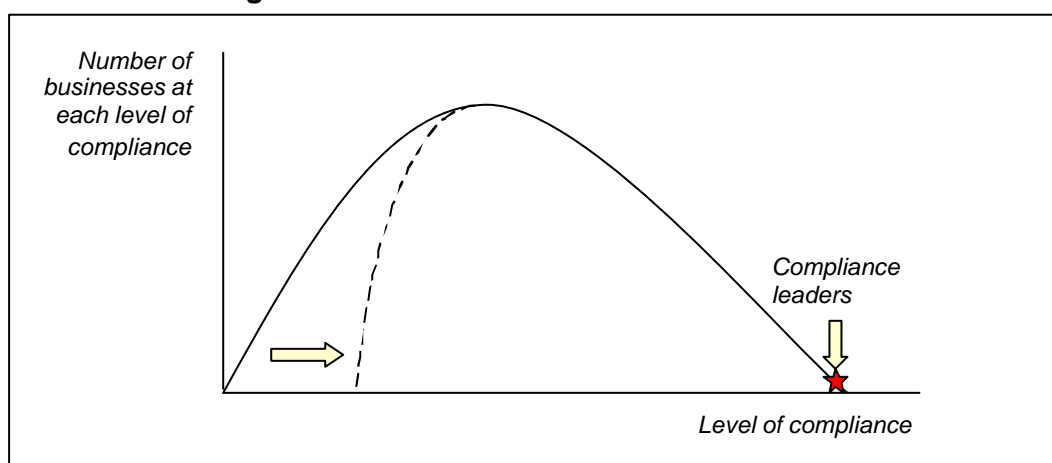
At the same time, however, the reforms associated with FRC require a uniformly high level of compliance. Compared to the previous self-regulatory regime, there is relatively little flexibility built into the new licence and authorisation conditions. For instance, if a business fails to pass on specific information within a certain time limit, or transfers a small retail customer without written consent, it has breached its obligations.

Therefore, if FRC is to be successful, it is necessary to shift the entire spectrum of compliance to the right of Figure A2.1. To do this, the Tribunal and businesses must work together to improve the level of compliance across the board. The experience of businesses with the most successful compliance records should be learnt from in order to move the entire spectrum of compliance to the right.

### A2.2 A regulatory approach to support a culture of compliance

A regulator that focuses on enforcement — ie monitoring compliance and imposing penalties on businesses that contravene their obligations — is likely to help bring the level of compliance among businesses with the poorest compliance records closer to the norm.

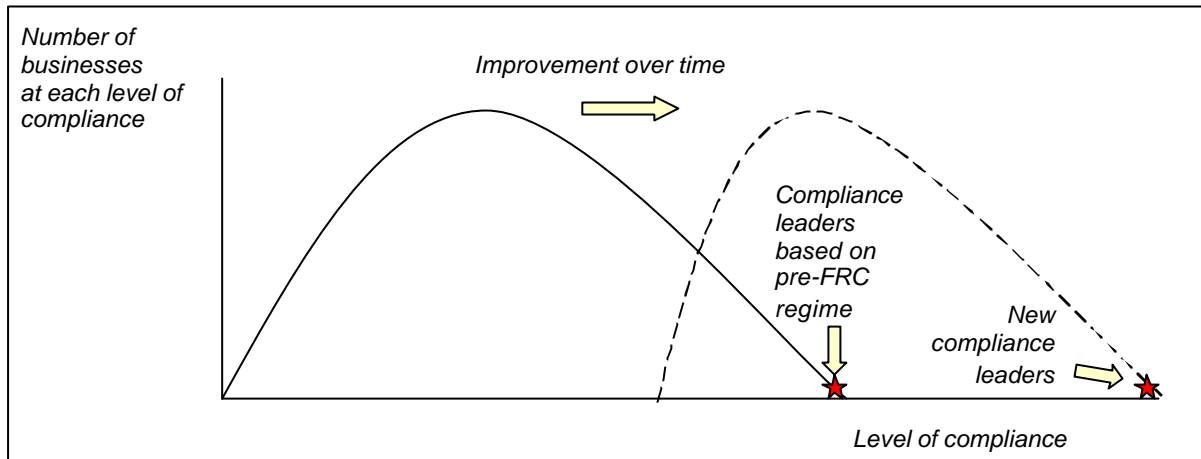
**Figure A2.2 Effect of enforcement activities**



Whilst this is a useful outcome, it has only a minor impact on the overall level of compliance. The Tribunal should address all three causes of non-compliance, rather than targeting businesses' willingness to comply.

Therefore, the Tribunal should assist businesses to increase the capacity to comply by helping them to understand their obligations, and (where possible) by refining the regime to make it easier to comply with while policy outcomes are still achieved. Of course, a realistic threat of enforcement should also be maintained for those businesses that remain unwilling to comply. Figure A2.3 shows how the overall level of compliance among businesses should ideally increase over time.

**Figure A2.3 Improving the level of compliance over time**<sup>131</sup>



The Tribunal believes that by adopting a responsive and collaborative approach to its regulatory activities, it can create a culture of compliance among NSW energy businesses. The goal of both the regulator and the businesses should be aligned, where the shared goal is to achieve the social, environmental and economic objectives identified in Government policy. A collaborative approach will permit Government policy objectives to be achieved more fully than if the Tribunal relied on force alone.

<sup>131</sup> C Parker, op cit, 2002.



## ATTACHMENT 3 COMPLIANCE REPORTING FORMATS

### Quarterly Compliance Report

Submitted by [*name*]

**To:** The Chairman  
Independent Pricing and Regulatory Tribunal of NSW  
Level 2, 44 Market Street  
Sydney NSW 2000

[*Name*] reports as follows:

1. This report documents compliance during [*quarterly period*] with all conditions classified as Type 2 conditions in the Tribunal's [*Reporting Manual(s) corresponding to licence/authorisation(s) held*], Version(s) A.
2. This report has been prepared by [*name*] with all due care and skill in full knowledge of conditions to which it is subject and in compliance with the Tribunal's Reporting Manual(s) for [*Reporting Manual(s) corresponding to licence/authorisation(s) held*], Version(s) A.
3. Schedule A provides information on all conditions with which [*name*] did not fully comply during [*quarterly period*].
4. Other than the information provided in Schedule A, [*name*] has complied with all conditions to which it is subject.
5. This compliance report has been approved and signed by the Chief Executive Officer of [*name*].

DATE:

Signed

.....  
Name:

Designation:

.....

### Schedule A: Non-Compliances

<b>List obligations breached including reporting manual table no.s and brief description of obligations.</b>	<b>Describe:</b> <ul style="list-style-type: none"><li>i. nature and extent of non-compliance (including whether and how many customers and/or licence/authorisation holders have been disadvantaged)</li><li>ii. likely cause</li><li>iii. remedial action taken</li><li>iv. actual/anticipated date of full compliance</li></ul>

## Annual Compliance Report

### Submitted by [*name*]

**To:** The Chairman  
Independent Pricing and Regulatory Tribunal of NSW  
Level 2, 44 Market Street  
Sydney NSW 2000

[*Name*] reports as follows:

1. This report documents compliance during [*financial year*] with all conditions to which [*name*] is subject by virtue of its [*licence/authorisation(s) held*].
2. This report has been prepared by [*name*] with all due care and skill in full knowledge of conditions to which it is subject and in compliance with the Tribunal's [*Reporting Manual(s) corresponding to licence/authorisation(s) held*], Version(s) A.
3. Schedule A provides information on all conditions with which [*name*] did not fully comply during [*financial year*].
4. Other than the information provided in Schedule A, [*name*] has complied with all conditions to which it is subject.
5. As required, the following additional information is attached to this report:
  - a. Statistical information and performance indicators relating to [*name's*] operations
  - b. [*A report against name's environmental plan*]
  - c. [*A report on promoting consumer safety awareness*]
  - d. [*An independent auditor's report on compliance with nominated conditions*]
6. This compliance report has been approved by the Chief Executive Officer and the Board of Directors of [*name*] at its meeting on [*date*].

DATE:

Signed

.....  
Name:

Designation:

.....

### Schedule A: Non-Compliances

<b>List obligations breached including reporting manual table no.s and brief description of obligations.</b>	<b>Describe:</b> <ul style="list-style-type: none"><li data-bbox="667 300 1417 421">i. nature and extent of non-compliance (including whether and how many customers and/or other licence/authorisation holders have been disadvantaged)</li><li data-bbox="667 421 916 450">ii. likely cause</li><li data-bbox="667 450 1043 479">iii. remedial action taken</li><li data-bbox="667 479 1294 508">iv. actual/anticipated date of full compliance</li></ul>