REVIEW OF ENERGY LICENSING REGIMES IN NSW: MOST EFFECTIVE REGULATORY MODEL

A Final Report for the Independent Pricing and Regulatory Tribunal

Prepared by NERA

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Sydney

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EXECUTIVE SUMMARY

This report has been prepared by National Economic Research Associates (NERA) for the Independent Pricing and Regulatory Tribunal (IPART).

Background

IPART has commissioned NERA to assist with its review of the NSW electricity and gas licensing regimes.[1] The consultancy services NERA has been asked to provide fall into three parts, namely:

i. to provide advice on the most effective model for the NSW electricity and gas licensing regimes, given the current institutional arrangements;

ii. to develop a compliance monitoring and reporting framework which IPART can implement to discharge its role as the NSW licence regulator; and

iii. to assess the need for minimum performance standards for licensed electricity and gas businesses, and to advise on the appropriate process for developing any such minimum performance standards.

This report covers the first of these parts, ie, recommendations on the most effective model for the NSW electricity and gas licensing regimes, given the current institutional arrangements. These recommendations cover an outline of the suggested framework for compliance monitoring and reporting, the co-ordination of administrative arrangements between agencies and some changes to the substantive content of licence obligations.

Drivers for Change to the Current Energy Licensing Regime

The focus of the review of the licensing arrangements is on improving compliance with existing government policy objectives.[2] There are two ways in which such an increase in compliance can be achieved:

i. through improving the extent to which licensees comply with the licence conditions placed on them; and

ii. through improving the extent to which licence conditions reflect government policy objectives.

In order to achieve the greatest overall improvement in compliance of licensed businesses with existing government policy objectives, it is therefore important to focus on making

1 We use the term 'licensing regime', 'licence' and 'licensee' in this report to refer to both licences and authorisations issued in the NSW electricity and gas sectors.

2 Terms of Reference from the Minister for Energy with respect to the Review of Electricity and Gas Licensing Regimes in NSW.

improvements in *both* of these areas, whilst being mindful of the costs associated with the compliance framework.

Section 4 of this report summarises a number of shortcomings of the NSW energy licensing regime. These shortcomings relate to both compliance administration and the extent to which current licence conditions reflect government policy objectives.

There are a number of reasons why it is desirable to address the shortcomings in the current NSW regime. The regime has evolved from one where the underlying regulatory philosophy was one of self-regulation, to one where the legislative framework has become more prescriptive, with more specific objectives. The associated monitoring and reporting framework therefore needs to be updated to reflect this change in approach and improve the effectiveness of the energy licensing regimes in delivering compliance with these specific objectives.

Furthermore, given the change in the underlying philosophy, the current arrangements impose costs on both licensees and the administering institutions (arising from report preparation and monitoring) in relation to what are, in some instances, now redundant or irrelevant obligations. Some ‘housekeeping’ is therefore required, in order to remove these obligations and thereby improve the cost effectiveness of the licence compliance regime.

In addition, the introduction of full retail competition in both electricity and gas in January 2002, provides a reason to address the current shortcomings of the regime now, rather than to defer action. To be effective, the consumer protection provisions introduced in connection with full retail competition[3] (which are enforced as licence obligations) will need to be adequately monitored and enforced to ensure that they are not breached.

The increasing number of private (rather than government-owned) businesses operating in the NSW energy sector and concerns about the lack of minimum performance standards in relation to the service quality performance of licensees are further drivers for changes to the current regime.

Generic Features of Effective Licensing Regimes

It is possible to identify *generic features* which characterise effective licensing regimes elsewhere, and which characterise well designed regulatory frameworks more generally. Specifically, effective licensing regimes are characterised by:

- unambiguous licence obligations which reflect policy objectives;
- transparent obligations;

[3] Via the Electricity Supply (General) Regulation 2001 and the re-drafted Gas Supply (Customer Supply) Regulation.

- an approach to the monitoring of different licence conditions which is tailored to the consequences of a breach of those conditions and provides clear and measurable criteria for compliance assessment;
- clear reporting requirements which are known in advance and only changed in accordance with a defined process involving consultation with licensees;
- processes which result in a high degree of confidence that reported compliance data is a true reflection of a licensee's compliance performance;
- a clear and credible enforcement policy, with enforcement (including penalties) tailored to the seriousness of the breach; and
- clear definition of the role and responsibility of different institutions in administering the licensing regime and the achievement of effective co-ordination between them.

Key Recommendations

In this report we present a number of proposals for changes to the NSW energy licensing regime which would enable the regime to better reflect the above features, whilst accommodating those elements of the institutional and legislative background which are not realistically open to change. Our key recommendations (set out in Section 5 of the report) are summarised below.

Administrative Arrangements:

Improving the Transparency of Obligations

i. Obligations on licensees should be made more transparent through the preparation of Consolidated Reference Documents issued in connection with each licence, which provide a comprehensive summary of all obligations on licensees, and what will be taken as demonstrating compliance with each obligation;

ii. These Consolidated Reference Documents would build on the current Ministerial Guidelines and Requirements, and should be living documents for which IPART has responsibility;

Administration of Licences

iii. As part of the process of issuing licences in both the electricity and gas sectors, potential licensees should be required to meet a financial threshold hurdle and to demonstrate *ex ante* that they have compliance processes which allow them to meet key licence obligations;

Compliance Monitoring

iv. Compliance monitoring processes should be developed by IPART in respect of both electricity and gas licensees;

v. Compliance monitoring should be tailored, based on the nature of the licence condition and the implications of a breach of that condition. Specifically, obligations on licensees should be classified as being of one of the following types:

- Type 1: an obligation for which *ex ante* assessment of compliance processes should be conducted;
- Type 2: an obligation for which frequent *ex post* compliance monitoring should be conducted (for example monthly or quarterly); and
- Type 3: an obligation for which annual *ex post* compliance monitoring should be conducted.

vi. Processes should also be put in place to enable ad-hoc compliance investigations to be undertaken, *either* by IPART *or* under a direction by the Minister for Energy (but not both).

Reporting Requirements

vii. Reporting requirements for both electricity and gas licensees should be standardised through the establishing of a Reporting Manual, prepared by IPART pursuant to a Reporting Guideline issued by the Minister.

viii. The Reporting Manual should be of the nature of a reporting pro-forma, and should also specify auditing requirements;

ix. The Minister's Reporting Guideline should specify the process by which future changes to the Reporting Manual will be made. This process should involve consultation with licensees and any changes should be made in advance of the reporting period to which they are to apply;

x. Electricity sector licensees should no longer be required to submit licence plans;

xi. External audits should be required for reported information in relation to all licence conditions for which e*x ante* compliance assessment is required (ie 'Type 1' conditions) and for reporting against specified 'Type 2' obligations;

xii. CEO certification and Board authorisation should continue to be required for reporting relating to all remaining licence obligations;

Enforcement

xiii. The Minister should consider setting out a clear enforcement policy as a means of enhancing the credibility of the enforcement regime;

Monitoring Compliance with the Marketing Code of Conduct

xiv. The monitoring of compliance with the Marketing Code of Conduct should be made the responsibility of *one* agency: either the Minister for Energy (in his role as Code Administrator) or IPART (as part of the monitoring of licence compliance).

Regulatory Roles and Functions of Each Agency

i. The roles and therefore the *responsibility* of all the institutions involved in monitoring compliance with licence obligations should be clearly defined, in order to avoid omissions and duplication of roles between agencies;

ii. The roles of different agencies should be co-ordinated through the adoption of Memoranda of Understanding (MOUs) or Protocols, as appropriate;

iii. IPART should retain its current overall responsibility for monitoring licence compliance and reporting to the Minister on licence compliance;

iv. The Ministry of Energy and Utilities should continue to be responsible for assessing licensees' Safety and Operating Plans and any aspects of technical performance governed by minimum standards. The Ministry should also continue its current monitoring role for compliance with safety and technical requirements.

v. Licence compliance assessment by IPART in relation to safety and technical obligations should relate only to submission and adequacy of Safety and Operating Plans, and the meeting (or failure to meet) of technical standards, as notified to IPART by the Ministry of Energy and Utilities;

vi. IPART and EWON should establish working procedures for notifying IPART of systemic customer complaints and any potential breaches of licence conditions (and the Marketing Code of Conduct, in the event that IPART is the agency appointed to monitor breaches with the Marketing Code of Conduct).

The Substantive Content of Licence Obligations

i. Licensees should be required to have a <u>complaint management system</u> which meets an approved external standard, such as AS 4269.

ii. The need for the inclusion of <u>prudential conditions</u> in licences should be reviewed, in the light of price regulation for monopoly distribution licensees and ROLR provisions for retail licensees. Our recommendation is that these conditions are removed.

iii. If prudential conditions are retained, the policy objective of retaining these conditions should be made clear. If IPART is the agency required to monitor compliance with these requirements, then IPART needs to develop a suitable monitoring capability.

iv. Minimum standards should be meaningful and should relate to aspects of licensees' performance which are of value to customers. The role of minimum standards will be considered further in part 3 of the consultancy project;

v. The policy objective(s) behind the requirement on licensees to submit key performance indicators should be made clear. Several possible objectives are suggested in this report. The performance indictors themselves should then be reviewed, to assess their appropriateness in the light of the policy objective(s);

vi. The current duplication and apparent redundancy of safety provisions included in businesses' licences should be removed by replacing the current licence conditions with an obligation to submit a Safety and Operating Plan (in line with obligations which already exist under regulations) and to operate in accordance with this Plan;

vii. In relation to environmental obligations, the reporting requirements for electricity distribution licensees in relation to their licence obligation to consider demand-side management as an alternative to network augmentation should be aligned with the National Electricity Code provisions which apply to network augmentation (and duplicate current licence requirements).

The Way Forward

The framework for reporting and compliance monitoring presented in this first report will be developed further, in consultation with interested parties, as part of the second part of the consultancy project. In particular, NERA will develop recommendations for the reporting requirements associated with specific licence obligations (including the content and frequency of reporting with respect to specific obligations) and the cycle of activities associated with compliance monitoring.

NERA will also address the role of minimum standards in more detail, as the third and final part of the consultancy project. Our recommendations will consider the need for minimum standards, the appropriate form of such standards and processes for developing standards.

NERA expects to report to IPART on the second and third parts of the consultancy project in early December 2001.

1. INTRODUCTION

This report has been prepared by National Economic Research Associates (NERA) for the Independent Pricing and Regulatory Tribunal (IPART).

The Minister for Energy has asked IPART to review the electricity and gas licensing regimes in NSW. [4] In particular, IPART has been asked to recommend any changes to the current administrative arrangements, or licence conditions, required to ensure improved compliance with existing government policy objectives.[5]

IPART has commissioned NERA to assist with its review of the NSW energy licensing regime. The consultancy services NERA has been asked to provide fall into three parts, namely:

i. to provide advice on the most effective model for the NSW electricity and gas licensing regimes, given the current institutional arrangements;

ii. to develop a compliance monitoring and reporting framework which IPART can implement to discharge its role as the NSW licence regulator; and

iii. to assess the need for minimum performance standards for licensed electricity and gas businesses, and to advise on the appropriate process for developing any such minimum performance standards.

This report covers the first of these parts, ie, recommendations on the most effective model for the NSW electricity and gas licensing regimes, given the current institutional arrangements. These recommendations cover both the substantive content of licence obligations and a suggested reporting and compliance monitoring framework.

The framework for reporting and compliance monitoring presented in this first report will be developed further, in consultation with interested parties, as part of the second part of the consultancy project. In particular, NERA will develop recommendations for the reporting requirements associated with specific licence obligations (including the content and frequency of reporting with respect to specific obligations) and the cycle of activities associated with compliance monitoring.

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5 Terms of Reference from the Minister for Energy with respect to the Review of Electricity and Gas Licensing Regimes in NSW.

NERA expects to report to IPART on the second and third parts of the consultancy project in early December 2001.

1.1. Scope of the Recommendations

It should be noted that, in putting forward recommendations for the most effective regulatory model for the NSW energy licensing regime, NERA has been asked to take certain current features of the NSW background as given. That is, we have not been asked to undertake a 'clean sheet' review. Rather, the challenge is to recognise the realities of the existing situation and to put forward recommendations which increase the effectiveness of the licensing regime whilst accommodating these realities.

In particular, NERA has been asked to assume a continuation of: (i) current energy-related government policies;[6] (ii) government ownership of electricity distribution network service providers and standard retailers; and (iii) existing institutional roles and responsibilities.

In addition, given the very recent reviews of the Electricity Supply Act, the Gas Supply Act and regulations in both the electricity and gas sector,[7] we have adopted the pragmatic approach of taking the content of the Acts and the regulations as, for the most part, given, and putting forward recommendations that are within these boundaries. However, we have commented in places where we feel that modifications of the Acts or the regulations would have benefits from the perspective of improving the effectiveness of the licensing regime in meeting government policy objectives.

1.2. Structure of this Report

The remainder of this report is structured as follows:

- Section 2 briefly sets out what we have taken as government policy objectives as well as the drivers for improvements to the current licensing regime;

- Section 3 presents generic features of effective licensing regimes, illustrated by examples of the regimes adopted in other jurisdictions, both in Australia and overseas;

- Section 4 highlights a number of shortcomings in the NSW energy licensing framework, and discusses the implications of these shortcomings;

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[6] This is consistent with the Minister for Energy's Terms of Reference to IPART, which refers to 'improved compliance with *existing* government policy and objectives' (emphasis added).

[7] In particular the Electricity (General) Regulation 2001 and the new Gas Supply (Natural Gas Retail Competition) Regulation 1997 which is currently being drafted by the Ministry of Energy and Utilities.

- Section 5 then draws on the generic features as the basis for putting forward recommendations for an effective energy licensing regime for NSW, whilst accommodating the current institutional and legislative framework of the NSW regime;

- Section 6 concludes with a summary of our recommendations.

Appendix A presents background to the current licensing arrangements in the NSW electricity and gas sectors, focusing on the roles of the various institutions involved, the legislative instruments and the current reporting requirements.

2. GOVERNMENT POLICY OBJECTIVES AND DRIVERS FOR CHANGE

The Terms of Reference issued by the Minister for Energy to IPART states that the aim of the review of the NSW energy licensing regime should be to improve the compliance of licensed businesses with existing government policy.[8]

There are two ways in which such an increase in compliance can be achieved:

i. through improving the extent to which licensees comply with the licence conditions placed on them; and

ii. through improving the extent to which licence conditions reflect government policy objectives.

In order to achieve the greatest overall improvement in compliance of licensed businesses with existing government policy objectives, it is therefore important to focus on making improvements in *both* of these areas.

This section provides a background to NERA's review by summarising what we have taken to be the government policy objectives in the energy sector, the role of licences in relation to meeting these objectives and key drivers for improving the current energy licensing regime in NSW.

2.1. Government Policy Objectives in the Energy Sector

In order to assess the extent to which changes to the current licensing regime could result in improved compliance with government policy objectives, it is important to be clear on what existing government objectives in the energy sector are.

Government's objectives in relation to the energy sector are set out in the Electricity Supply Act 1995 and the Gas Supply Act 1996.[9] Although expressed slightly differently in the legislation, these objectives can be paraphrased as:

- the development of a competitive retail market in both electricity and gas;
- the promotion of environmentally responsible production and use of electricity and gas;

[8] Terms of Reference from the Minister for Energy with respect to the Review of Electricity and Gas Licensing Regimes in NSW.

[9] Electricity Supply Act 1995, Part 1 Clause 3; Gas Supply Act 1996, Part 1, Clause 3.

- the safe and reliable supply of electricity and gas, and the promotion of the safe use of gas; and
- the promotion of customer choice and the protection of customers' interests.

The achievement of the first objective of developing a competitive retail market is expressed as a means of achieving the second two objectives; namely, efficient and environmentally responsible production and the safe and reliable supply of electricity. [10]

There are a number of ways in which the government may decide to pursue the policy objectives outlined above. For example, in order to promote the environmentally responsible production of electricity, the government may decide to introduce a mechanism which places a direct monetary cost on greenhouse gas emissions (such as a carbon tax), in order to internalise the cost of such emissions in businesses' production and consumption decisions. Alternatively, the government may decide to impose direct obligations on electricity retailers to source a certain proportion of their electricity purchases from low emission generation sources.

It is beyond the scope of the current report to consider the most appropriate means by which each of the government's policy objectives could be advanced. Rather, our focus is on assessing the effectiveness of the licence obligations currently placed on businesses in furthering the government's existing policy objectives. That is, where the decision *has already been taken* to further a policy objective through placing an obligation on a licensed business, we assess the effectiveness of the obligation and consider alternatives.

2.2. Drivers for Change

In putting forward recommendations for change, it is important to be clear on the reasons for seeking improvements to the current regime, the Minister's Terms of Reference to IPART notwithstanding.

In section 4 of this report we discuss a number of shortcomings in the current NSW energy licensing regime. These shortcomings relate to both compliance administration and the extent to which current licence conditions reflect government policy objectives.

Many of the shortcomings of the current licensing regime stem from a change in the underlying philosophy driving the regime, which has not been reflected in changes to actual licence conditions or the way in which compliance with those conditions is monitored. When the energy licensing regime in NSW was initially established, it was driven by the philosophy the regime should be one of 'self-regulation' as far as possible. As a result,

[10] In addition, we note that the Electricity Act refers to the objectives of providing network operators with powers to construct, operate, repair and maintain their electricity networks; and the provision of open access to distribution networks.

licensees were given considerable discretion to determine customer service standards and (in the case of electricity sector licensees) to collectively develop Codes of Practice covering various aspects of licensees' behaviour. This philosophy is reflected in the current electricity licence condition for licensees to develop their own 'licence plans', governing aspects of their behaviour, and the relatively wide degree of freedom under the Gas Supply (Customer Protection) Regulation 1997 given to gas suppliers and gas distributors to prepare customer service codes.

Over time, the legislative regime has become more prescriptive, in terms of the obligations placed on licensees. For example, a number of regulations now place specific obligations on licensees in areas where previously licensees were left to develop their own policies, most notably the most recent Electricity (General) Regulation, and the new Gas Supply (Natural Gas Retail Competition) Regulation. In electricity, there has also been the introduction of specific obligations under the National Electricity Code, as a result of NSW being part of the wider NEM, which have superseded previous self-regulation (for example, the Franchise Customer Metering Code) or impose obligations which duplicate existing licence obligations.

This increase in prescriptiveness has not been reflected in an updating of the licensing regime. As a result, in a number of areas licensees now face conflicting or duplicate obligations, or face obligations which are now redundant. This both increases the complexity of the regime (which in turn increases the likelihood of non-compliance), and also the cost which the current licensing regime imposes on both licensees and the administering institutions, associated with reporting requirements and monitoring functions. To the extent that current licence conditions impose compliance costs without meaningfully furthering the government's objectives, a better designed licensing regime can improve the use of society's resources.

The first driver for change is therefore the need for a general 'housekeep' of the current regime to ensure that it adequately reflects the changes in the legislative arrangements which have occurred to date, and is not imposing unnecessary reporting and compliance costs on licensees and the administering institutions.

In addition, there are a number of reasons why it is desirable to address the shortcomings in the current NSW regime now, rather than to defer action.

The first of these is the introduction of full retail competition in both electricity and gas in January 2002. As noted above, the introduction of full retail competition has been accompanied by the introduction of more prescriptive consumer protection provisions, via the Electricity Supply (General) Regulation 2001 and the Gas Supply (Natural Gas Retail Competition) Regulation 2001.[11] The regulation provisions provide customers with

[11] The Gas Supply (Natural Gas Retail Competition) Regulation 2001 is currently in the process of being re-drafted by the Ministry of Energy and Utilities and will replace the current Gas Supply (Customer Protection) Regulation

protection from practices and behaviour which have been experienced elsewhere with the introduction of full retail competition, such as customer ‘slamming’. However, effective monitoring and enforcement of the provisions will be required to ensure that the protections provided under the regulations are not breached. That is, it is unlikely to be enough simply to have *specified* the customer protection requirements; achieving *compliance* with the requirements which have been specified will also necessitate effective monitoring and enforcement.

The regulations themselves specify that compliance with the customer protection provisions is a licence condition for both electricity and gas licensees.[12] Therefore, ensuring that customers are adequately protected following the introduction of full retail competition, and that any breach of the customer protection provisions is picked-up in a timely fashion, provides a key driver for improving the current licence compliance regime.

In the electricity sector, a further driver compounding that provided by the introduction of full retail competition is the fact that many of the new entrants expected (or already present) in the electricity retail market will be private businesses. Currently, the four electricity retail licence holders serving the small retail customer market are all owned by the NSW government. Where a business is government-owned, businesses’ behaviour may be influenced by channels other than the imposition of licence obligations. As a result, the effectiveness of current licence obligations may be less of a concern since the licence is not the only (and may not even be the primary) instrument by which obligations are imposed on businesses. However, where a business is privately owned, legislative instruments[13] become the primary means of imposing obligations on businesses. As a result, the effectiveness of achieving compliance with those obligations becomes much more important. We note that, of the twenty-one current electricity retail licence holders in NSW, more than half are private companies.

A final driver for change are concerns about the lack of minimum standards for the service quality performance of licensees, which have been expressed by customer groups and by IPART (in its role as price regulator). This is particularly the case where the regulatory regime has strong incentive for businesses to seek cost efficiencies, which (in the absence of adequate safeguards) may be at the expense of service quality.

The issue of ensuring service quality standards, and in particular the quality of monopoly services, is one which can be tackled in a variety of ways. One possibility would be through the introduction of explicit incentives for improvements in service quality as part of the

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1997. We understand that the revised regulation will mirror the provisions in the recently issued Electricity (General) Regulations 2001, and that compliance with the obligations in the regulation will be an authorisation condition.

12 Even if compliance with regulations was not administered as a licence condition, the need for having an effective monitoring and compliance regime for compliance with obligations in regulations would remain.

13 Such instruments include licences, regulations and codes of practice.

approach to the regulation of prices of monopoly services. This is the approach adopted by the ORG in its recent regulatory review of electricity distribution businesses in Victoria, and is also the option currently being implemented by Ofgem for electricity distribution businesses in the UK. IPART is currently actively pursuing investigations into the appropriateness of adopting this approach in NSW.

An alternative, or complementary, path to addressing concerns over service quality is the introduction of minimum standard obligations via the licensing framework. Both the ORG and Ofgem have incorporated minimum service standards into their regulatory regimes. The consideration of the appropriate role of minimum standards is the focus of part 3 of this consultancy project. To the extent that it is decided to introduce minimum standard, achieving effective compliance with the standards introduced would represent a key driver for improving the current operation of the licensing regime.

3. KEY FEATURES OF AN EFFECTIVE LICENSING REGIME

The effectiveness of a particular licensing regime will depend on a number of factors, including (but not limited to):

- the specific details of the legal and regulatory background within which it sits;
- the political context;
- the ownership of the licensees (ie, whether publicly or privately owned).

It is not therefore possible to identify a single regime operating elsewhere as the 'ideal model' for energy sector licensing.

It is, however, possible to identify *generic features* which characterise effective licensing regimes elsewhere, and which characterise well designed regulatory frameworks more generally. These generic features can be used as criteria for evaluating alternative recommendations for improving the NSW energy licensing framework, and as anchor points for making choices going forward.

Effective licensing regimes are characterised by:

- unambiguous licence obligations which reflect policy objectives;
- transparent obligations;
- an approach to the monitoring of different licence conditions which is tailored to the consequences of a breach of those conditions and provides clear and measurable criteria for compliance assessment;
- clear reporting requirements which are known in advance and only changed in accordance with a defined process involving consultation with licensees;
- processes which result in a high degree of confidence that reported compliance data is a true reflection of a licensee's compliance performance;
- a clear and credible enforcement policy, with enforcement (including the imposition of penalties) tailored to the seriousness of the breach; and
- clear definition of the role and responsibility of different institutions in administering the licensing regime and the achievement of effective co-ordination between them.

In the remainder of this section we expand on each of these key features. In the case of administrative arrangements, we draw on examples of licensing regimes in other jurisdictions to illustrate the features discussed. Each of these regimes contains, to a greater or lesser extent, some or all of the features noted above. In section 4 we discuss shortcomings of the current NSW regime. In section 5 we then present proposals for changes to the NSW licensing regime which would enable the regime to better reflect these generic key features, whilst accommodating those elements of the institutional and legislative background which are not realistically open to change.

3.1. Licence Obligations Should Reflect Policy Objectives

For compliance with a licensing regime to further government's policy objectives, the obligations included in a businesses' licence must themselves be clearly linked to those objectives and compliance with the obligation must be meaningful.

The obligations reflected in licence conditions should relate to the furthering of objectives under primary legislation. In addition, the licence obligations should be *specific* to the class of business covered by the licence. It is also important that there is consistency and clarity between the obligations imposed on licensees.

Compliance with licence obligations should also result in a meaningful outcome, which furthers the policy objective. To the extent that licence conditions refer to the preparation of plans or strategies by the licensee, such plans or strategies should be subject to approval (or rejection) by a specified institution, and guidance should be provided on the coverage of the plans. To be meaningful, the failure to comply with aspects of any prepared plan should result in some form of sanction.

Any obligation on licensees to comply with minimum standards (often called 'Guaranteed Service Levels') should have a clear rationale in terms of government objectives. Typically such a rationale will be related to customer protection. In this case, the minimum standards imposed should reflect customer requirements and preferences.

Where licensees are required to provide information on performance indicators as a condition of their licence, the rationale for providing such information, in terms of how it relates to government objectives, should be clear.

3.2. Administrative Arrangements

3.2.1. Transparency

Effective licensing regimes are characterised by obligations on licensees being either set out in the same place, or clearly cross-referenced. Such transparency allows businesses to understand what their obligations under the licensing regime are. This helps in reducing any perceived barrier to entry: where obligations are unclear, new entrants incur a cost in becoming familiar with all of the obligations which apply to them.

Transparency of obligations also lessens the risk to licensees that they find themselves in breach of an obligation which they either were not aware or, or which they had interpreted in a different way.

Transparency of obligations can be achieved through having a 'consolidated licence', which brings together all of a businesses' obligations within the single licence document. The key advantage of a consolidated licence is transparency. There is no need for the licence holder to refer back to the primary legislation and regulations to make themselves aware of their obligations.

However, a consolidated licence can end up as a large and unwieldy document, where there are a large number of obligations on licensees. It would also need to be regularly updated to ensure that it continues to accurately reflect the underlying obligations. As a result, it is often preferable to retain a smaller licence document, and to issue a subsidiary 'Code' or 'Consolidated Reference Document' which acts as a comprehensive statement of obligations.

3.2.1.1. Transparency of obligations in other jurisdictions

Sydney Water currently operates under what is in effect a consolidated licence, which contains the majority all of the obligations the business faces.[14] In the UK, the energy sector licences contain significant detail in relation to licensees' obligations, including guidelines on the development of Codes of Practice. In the US states of Maine and Massachusetts, the state Public Utilities Commissions each have a commission rule which clearly spells out the obligations on electricity retail licensees.

In other jurisdictions in Australia, the obligations on licensees arising under primary legislation, regulations, licence conditions and formal codes of practice are summarised in 'Codes', issued as a subsidiary documents to the main licences. For example, both Victoria and South Australia have Retail and Distribution Codes issued pursuant to the electricity retail and distribution licences, although in both jurisdictions, there are still also subsidiary guidelines issued in addition to these Codes.

3.2.2. Monitoring linked to nature of and consequences of breach

Effective licensing regimes are characterised by monitoring arrangements which are tailored to the nature and seriousness of breaches, in order to provide timely information on key breaches and to ensure that monitoring is cost effective.

In a number of jurisdictions, compliance monitoring focuses on *ex ante* assessments that licensees have effective compliance processes in place, coupled with *ex post* reporting on the outcome of those processes. The approach adopted by Ofgem in the UK for electricity distributors and the SAIIR in South Australia for all electricity sector licensees are both

[14] The Operating Licence notes that Sydney Water has obligations under a number of laws, including:

- Protection of the Environment Operations Act 1997;
- Public Health Act 1991;
- Water Legislation Amendment (Drinking Water and Corporate Structure) Act 1998;
- Water Act 1912; and
- Independent Pricing and Regulatory Tribunal Act 1992.

illustrations of ex ante compliance process monitoring (see section 3.2.2.1 below). Such an approach is *proactive*, in that it aims to avoid licence breaches, by requiring licensees to demonstrate that they have systems in place to prevent the occurrence of a breach. The effectiveness of such an approach is enhanced to the extent that the *ex ante* assessment of compliance is subject to independent auditing and that the license compliance agency has an approval role, which it actively uses.

Compliance monitoring also varies in the speed with which *ex post* monitoring is undertaken. Approaches can be characterised as either '*fast reactive*' or '*slow reactive*', depending on the elapsed time between a breach occurring and that breach being picked up by the compliance monitoring process. The time lag before licence breaches are discovered is a key factor in determining both the impact of a breach (breaches are likely to have a greater impact the longer they go undetected) and the action (and therefore the cost) required to address the consequences of a breach.

Effective licensing regimes are characterised by the presence of 'fast reactive' monitoring for appropriate licence conditions, which act as 'early warning systems' with respect to breaches of those conditions. The licence conditions for which 'fast reactive' monitoring is appropriate are those where a sustained breach of the condition has a significantly greater impact on customers and other market participants than a limited breach, and where a delay in addressing the breach increases the cost and difficulty of again achieving compliance. Fast reactive monitoring approaches are characterised by the frequency of reporting requirements (which can range from 'as soon as the licensee is aware of a breach' to monthly or quarterly) and tailored information flows from other agencies (such as agencies which receive customer complaints) to ensure that the monitoring agency has alternative channels for becoming aware of licence breaches.

Given that the costs of monitoring can be expected to increase (for both the monitoring agency and licensees) with increases in the frequency of reporting requirements, a further feature of effective monitoring regimes is the targeting of frequent reporting requirements (ie, 'fast reactive' monitoring) only on those licence conditions where there is a benefit from receiving compliance data more frequently.

3.2.2.1. Ex ante focus on compliance systems

In the UK electricity sector, compliance with licence conditions for electricity distributors is covered by an *ex ante* statement required from licensees setting out the procedures and systems they have adopted to ensure compliance (subject to audit by the licensee's 'compliance officer') and *ex post* reporting of the effectiveness of those compliance systems.

Condition 40 of the electricity distribution licence places an obligation on the licensee to prepare a statement outlining the practices, procedures and systems they intend to set in place to ensure compliance with the licensees' obligations. This statement is required to be in a standard format approved by Ofgem.

The licence condition also requires the licensee to appoint a Compliance Officer to perform the following functions:

- provide the licensee with advice on its compliance with the relevant duties;
- monitor the effectiveness of its practices, procedures and systems;
- investigate any complaints made to the licensee with regard to licence compliance issues, and advise on action to be taken as a result of such an investigation; and
- report annually to the directors of the licensee on issues arising from these duties.

The licensee is also required to produce an annual report, for submission to Ofgem, on;

- the activities of the Compliance Officer during the year;
- matters arising, relating to practices, procedures and systems;
- the number and type of complaints investigated;
- the outcome of investigations; and
- remedial action taken following investigations.

This annual report is required to be made available by the licensee to anyone requesting it.

Licence compliance monitoring in the South Australian electricity sector is also focused on the *processes* licensees have in place to ensure that they comply with the licence conditions. In particular, the SAIIR's Compliance Report requires that licensees have, and rigorously adhere to, a sound compliance scheme. Licensees are required to report to the SAIIR that the compliance processes they have in place are expected to be effective. The SAIIR guidelines note that a sound compliance system may be based on Australian Standard AS3806 or 'any other credible compliance standard'.[15] The licensees' compliance scheme must ensure that:

- all applicable obligations have been identified;
- a 'Responsible Officer' has been identified who has operational control over the activity or work area where the relevant obligation arises;
- the Responsible Officer has programmed the applicable obligations into the operational procedures for the relevant activity or work area, and is accountable to the Board of Directors (or the Compliance Committee of the Board of Directors) through the Chief Executive for ensuring compliance with the applicable obligation;

15 SAIIR, Compliance Systems and Reporting, Electricity Industry Guideline No. 4, 31 March 2001.

- the CEO of the licensed entity will be made aware of any breaches of the applicable obligations without delay;
- remedial action is taken as soon as possible to rectify breaches of applicable obligations, and that the breach and the completion of the remedial action is reported to the Board (or the Compliance Committee of the Board of Directors); and
- the compliance system is reviewed:
  - every two years
  - whenever continued breaches indicate systemic failure, to ensure that the compliance system is effective and relevant; and
  - where there is significant change to the regulatory regime, in order to update the system to accommodate the change.[16]

Compliance monitoring focuses on periodic statements by the licensees that they have effective processes in place, and 'exception reporting' of any instances of non-compliance. This monitoring is on the basis of a tiered-approach, with different licence conditions having different reporting frequency (see section 3.2.3.1 below).

3.2.2.2. Targeted monitoring

The South Australian electricity sector also provides a clear example of targeted monitoring, based on a 'tiered' approach. The SAIIR has explicitly identified different categories of reporting requirements for different obligations faced by licensees.[17] Specifically, each licence condition applying to electricity distributors and electricity retailers, together with each obligation identified under the Retail Code and Distribution Code issued under the licence, is classified as requiring one of four reporting types:

- Type 1 conditions require breaches to be reported immediately;
- Type 2 conditions require quarterly reporting;
- Type 3 conditions require annual reporting; and
- Type 4 conditions require biennial reporting.

The SAIIR retains the right to change the categorisation of obligations at any time, including in response to reports of non-compliance.

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[16] SAIIR, Compliance Systems and Reporting, Electricity Industry Guideline No. 4, 31 March 2001, Annexure C.

[17] SAIIR, Compliance Systems and Reporting, Electricity Industry Guideline No. 4, 31 March 2001.

Those conditions classified as requiring immediate or quarterly reporting are summarised in Table 5.1. Of particular note is that, for (franchise) retail licensees, quarterly reporting is required for a range of customer protection conditions.

Table 5.1: Type 1 and Type 2 Reporting Requirements for Electricity Licensees, South Australia

Type 1 Reporting: Immediate Notification of Breaches	
Distribution licence	**Condition 15.1(a):** Financial and technical ability to continue operations **Condition 25:** Public Safety and system security
Retail licence	**Condition 12.2(a):** Financial and technical ability to continue operations
Type 2 Reporting: Quarterly Compliance Report	
Distribution licence	**Condition 6:** Notify a material breach of the Code **Condition 15:** Notify change of officers or major shareholders **Condition 17:** Notify cross-ownership breach **Condition 12.1(b) and (c)**: separation of business **Distribution Code**: Emergency disconnections; discontinuation of country services
Retail (franchise) licence	**Licence Conditions:** Same as for distribution licence **Retail Code**: customer sale contract compliance; customer charter compliance; reconnection procedures; standard customer sale contract

Note: Any breaches of any of the Type 2 licence conditions are to be reported to SAIIR within 3 or 5 days of the event. The Quarterly Compliance Report certifies that licensees have complied with all Type 2 obligations, and provides details for any exceptions.

In Victoria, the ORG requires annual external audits of the compliance by electricity and gas licensees against key licence obligations, and also external audits of the quality of the data on performance indicators submitted by the licensees. Prior to each audit, the ORG determines what is to be included in the scope of the audit. In deciding which are the key licence conditions to monitor, the ORG has regard to both the *likelihood* of non-compliance and the *consequences* of non-compliance.[18]

Specific factors included in the ORG's decision are:

- the cost to customers or the public of non-compliance;
- danger to public health or safety;
- damage to property;
- loss or reduction of essential service;

[18] See Electricity Industry Guideline No. 9, Regulatory Audits, the Office of the Regulator-General, July 1999 and Gas Industry Guideline No. 8, Operational and Compliance Audits, June 2001.

- environmental damage;
- adverse public reaction;
- threat to actual or comparative competition; and
- the likely or known extent of non-compliance.

The ORG's aim is to minimise the cost of compliance audits whilst at the same time minimising the probability that significant non-compliance will go undetected.

In addition, the ORG's Memorandum of Understanding with the Energy and Water Ombudsman of Victoria ensures that the ORG will be made aware of any systemic breaches of licence conditions in relation to customer protection, as soon as such breaches have been identified (see section 3.2.6).

3.2.3. Reporting requirements clear and known in advance

Effective licensing administration regimes are characterised by clear reporting requirements, which are determined in advance. Knowing reporting requirements in advance provides licensees with the appropriate degree of certainty that the information they are collecting through their internal compliance monitoring systems is relevant and will meet the monitoring agency's reporting requirements.

In order to maintain this benefit of certainty, changes to reporting requirements should be limited and should only be made according to a pre-established process. Such a process should be known to licensees (and other interested parties) in advance, and should include appropriate consultation with licensees.

It is also important that licensees know *why* they are being required to provide certain information. This increases the incentive on licensees to comply with reporting requirements; where licensees doubt that the data they are submitting will in fact be used, they have less incentive to ensure that the data is rigorously collected. Moreover, to the extent that the licence monitoring agency is required to be clear on why it is requesting certain information, this focuses attention on the usefulness of the data, and may result in more focused (and therefore more cost-effective) reporting requirements.

3.2.3.1. Reporting requirements in other jurisdictions

The SAIIR has issued reporting guidelines with respect to licence compliance for electricity sector licensees.[19] The overall approach is one of 'exception reporting'. Licensees are required to submit a simple statement that they have maintained a compliance program

[19] SAIIR 'Compliance Systems and Reporting. Electricity Guideline No. 4' March 2001. Reporting pro formas are given in Annexure C of the guidelines.

during the relevant period and that they have complied with all relevant conditions, with the exception of those listed in an attachment. The attachment pro forma then requires a list of licence or code conditions where there has been a breach, together with a brief description of the breach. The licensee is also required to comment on (i) the impact of non-compliance on consumers and other entities; and (ii) implications for the effectiveness of the licensee's compliance system. The compliance reports need to be signed by senior personnel of the licensee, as specified in the reporting guidelines (Chief Executive Officers or the Board of Directors). The document which sets out the reporting guidelines include a section on 'processes for revision' which commits the SAIIR to undertake consultation with relevant licensees and other stakeholders before making significant amendment to the information requirements, and to provide at least 45 days notice of revisions.

The SAIIR has also issued reporting guidelines with respect to operational performance reporting.[20] Reporting on aspects of performance is required under the Distribution and Retail Codes issued pursuant to the Distribution and Retail licences. The pro-formas set out what information needs to be reported on (eg, time taken to respond to telephone calls, information on disconnections) and frequency (typically quarterly). The operational performance report includes a 'responsibility statement' which needs to be signed by the licensees' Chief Executive Officer. The guidelines documents again include a section on 'process for revision' which commits the SAIIR to undertake consultation with relevant licensees and other stakeholders before making significant amendment to the information requirements, and to provide at least 45 days notice of revisions.

Ofgem's reporting requirements include the annual compliance report submitted by each licensee's Compliance Officer. Licensees are required to make this compliance report available to anybody who requests it. Licensees are also required to report on their performance under various codes of practice.[21] Ofgem publishes a summary of licensees' performance.[22]

In addition, Ofgem issues and annual reports on businesses' performance, including statistics on performance against guaranteed and overall standards of performance, information on customer complaints received by Ofgem, disconnection for non-payment of bills and the number of prepayment meter customers per company. The information is

[20] SAIIR 'Electricity Regulatory Information Requirement – Distribution. Electricity Guideline No. 1' December 2000. 'Electricity Regulatory Information Requirement – Retail Code Retailer. Electricity Guideline No. 2' November 2000.

[21] Both distribution and retail licensees in the electricity and gas sectors are required to develop a number of codes of practice as a condition of their licence. These include a Code of Practice for Payment of Bills and Guidance for Dealing with Customers in Difficulty (for retail licensees), and a Code of Practice for the Provision of Services for Persons who are of Pensionable age or Disabled or Chronically Sick (all licensees). The licences themselves set out detailed requirements on what these codes of practice should cover. Licensees are required to have their Codes of Practice approved by Ofgem.

[22] For example: Ofgem. February 2001 Monitoring domestic Electricity and Gas Suppliers' Performance under Their Codes of Practice. http://www.ofgem.gov.uk/docs2001/12_monitoring.pdf

published alongside performance for previous years enabling a comparison of company performance and changes in performance over time.[23]

3.2.4. Reliability of reported information

In an effective licence administration regime, the monitoring agency is able to rely on the information received from licensees in respect to compliance monitoring. The ability to rely on submitted data reduces the monitoring agency's costs, since it does not have to undertake verification checks on the data submitted. In addition, reliable data improves the effectiveness of the compliance monitoring regime, since there is greater assurance that instances of non-compliance will be detected.

In order to ensure the reliability of data, monitoring agencies typically require data to be externally audited. However, it needs to be recognised that the use of external audits imposes a cost on licensees. Therefore, the greater the extent that audit requirements can be targeted, the more cost-effective the regime. An alternative to requiring an external audit is to require high-level sign-off of compliance reports by either the Chief Executive Officer or the Board of Directors of the licensee. Such sign-off may invoke the provisions of companies law, depending on the jurisdiction. However, its more immediate role is to ensure that adequate focus and attention is given by the management of the licensee to the compliance report, and that responsibility for the report's accuracy has been imposed at a clear, discernable and high level.

3.2.4.1. Use of audits in other jurisdictions

The SAIIR requires licensees' Compliance Reports to be audited, before being submitted to the SAIIR. However, there is no requirement for this audit to be conducted by an external party, and licensees have typically adopted internal audits. The SAIIR requires CEO and Board sign-off of the Compliance Reports, and views this high level endorsement as an effective substitute for independent assessment. In the case of repeated breaches of licence conditions, the SAIIR notes in its guidelines on compliance reporting that it may require an external audit.[24] In this case, or where a licensee voluntarily decides to appoint an external auditor, the licensee is required to obtain SAIIR approval of the auditor. The audit is paid for by the licensee.

In Victoria, audits must be conducted by independent auditors appointed by the licensee and approved by the ORG. The ORG must approve the audit firm and the audit team. Auditors are required to enter into a tripartite deed with the ORG and the licensee. Auditors must be independent of the licensee and must not also undertake work for the licensee which could create a conflict of interest. As discussed in section 3.2.2.2, the ORG uses a 'risk

23 For example, Ofgem. 28 September 2000. Report on services for electricity customers 1999/00.

24 SAIIR 'Compliance Systems and Reporting. Electricity Guideline No. 4' March 2001, section 3.1.1..

assessment' approach to focus the scope of the audit, rather than requiring an external audit of all reporting by licensees.

In the UK the approach to auditing information differs across regulators. In the water sector, companies are required to appoint a 'reporter' to examine, test and give their opinion on the information submitted by licensees. In most instances, reporters are chartered consulting engineers who are supported by a team including finance and business management expertise. Reporters provide reports to Ofwat covering key concerns and any issues not covered by the company in their submission. In addition, Ofwat employs external consultants to review the reporter process.

Ofgem do not rely on reporters, but instead rely on independent auditors. Ofgem intends to appoint auditors to audit the information gathered in relation to its Information and Incentives Project (IIP). In particular, the auditors will audit licensees' measurement systems and audit a sample of the information that has been submitted. Ofgem intends to retain one set of auditors across all licensees to ensure consistency, and to ensure that the information is recorded to the required level of accuracy.

3.2.5. Clear enforcement policy

The credibility of a licensing regime depends crucially on having a clear and effective licence enforcement policy. Where a licensee knows that non-compliance will result in a penalty, it has an incentive to comply with the licence condition.

In most jurisdictions, there is a person or agency who ultimately has the power to revoke a business' licence for breaches of licence conditions. However, licence revocation is very much a 'nuclear option', particularly for monopoly businesses such as electricity and gas distribution, but also for large incumbent retail businesses in a competitive market. Licensees are aware that licences are unlikely in practice to be revoked, except for the most serious breaches. Even in the latter case, the step taken by the enforcing body is more likely to be the appointment of administrators, to ensure that the business continues operating, rather than simply licence revocation. Where the powers to appoint an administrator are not granted under primary legislation, the threat of licence revocation is further weakened.

To be credible, alternative enforcement penalties to licence revocation should be clearly articulated, and actively used when necessary. Penalties should also be tailored to the seriousness of a breach, in order to make them credible.

In Victoria, the ORG has the power to issue a maximum penalty of $100,000 for a licence breach, plus an additional $10,000 a day while the breach continues.[25] In South Australia, the SAIIR has the power under the Electricity Act to impose a penalty for a licence breach of either up to $250,000, or to recover through the court system the additional profit that a

[25] Office of the Regulator-General Act 1995, Part 5, Section 35.

company has made as a result of breaching its licence condition (this amount may exceed $250,000).[26]

In the UK, the Utilities Act 2000 includes the power under Section 27 for Ofgem to levy fines of up to 10 per cent of company turnover for breaches of licence conditions. The Act states that the amount of any penalty 'must be reasonable in all the circumstances of the case'. At the end of the financial year, Ofgem must produce an annual report which includes a summary of final and provisional orders it has made and any penalties it has imposed during the year.[27]

3.2.5.1. Ofgem's Statement of Policy with Respect to Financial Penalties

As noted above, the Utilities Act 2000 includes the power under Section 27 for Ofgem to levy fines of up to 10 per cent of company turnover for breaches of licence conditions. The Act states that the amount of any penalty 'must be reasonable in all the circumstances of the case'. It also obliges Ofgem to produce a statement of policy with respect to financial penalties, having undertaken such consultation as it considers necessary.[28]

Ofgem's statement of policy sets out the criteria which Ofgem will consider in deciding whether it would be appropriate to impose a penalty. The factors Ofgem considers as tending to making the imposition of a financial penalty more likely include:

- where the contravention or failure has damaged the interests of consumers or other market participants; and
- where imposing a financial penalty would be likely to create an incentive to improve compliance and deter future breaches.

Factors which make the imposition of a financial penalty less likely include:

- if the contravention were of a trivial nature;
- that the principal objective and duties of Ofgem preclude the imposition of a penalty; and
- that the breach or possibility of a breach would not have been apparent to a diligent licensee.

In setting the level of financial penalty Ofgem states that it will consider:

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[26] SA Electricity Act 1996, Section 25 (1) and (2).

[27] Utilities Act, Section 5(2)(c)

[28] Ofgem. April 2001 Utilities Act: Statement of Policy with Respect to Financial Penalties http://www.ofgem.gov.uk/docs2001/penalties-policy-statement.pdf

- the seriousness of the contravention or failure
- the degree of harm or increased cost incurred by consumers or other market participants
- the duration of the contravention or failure; and
- any gain (financial or otherwise) made by the licensee.

Financial penalties will be higher where there has been repeated or extended breaches of licence conditions, where senior management has been involved in a contravention and where there is the absence of any internal mechanisms or procedures intended to prevent licence breaches.

3.2.6. Responsibilities of institutions clearly defined and co-ordinated

The final key feature of effective licensing regimes is that the roles and *responsibility* of institutions involved in monitoring and enforcing compliance with licensing obligations are clearly defined, and, where more than one body is involved in the licensing regime, that there are formal arrangements in place to achieve co-ordination and avoid reporting over-lap.

The simplest and most effective way of ensuring that responsibility for compliance monitoring and enforcement is clear, is to appoint a single agency with overall responsibility in each case, ie, a single agency with responsibility for compliance monitoring and a single agency (which may be, but need not be, the same agency with responsibility for monitoring) with responsibility for compliance enforcement. This 'single responsibility' model has the advantages of minimising the scope for duplications and omissions to arise in carrying out monitoring and enforcement functions.[29]

However, given that licence conditions cover obligations in a range of areas, it is probable that a single institution will not have all of the skilled personnel necessary to adequately monitor compliance across all licence obligations. Rather, it is likely that the skills required will be spread across different institutions. To attempt to replicate these differing skill sets in one 'license monitoring institution' may well result in unnecessary duplication of skills.

In order to have a well functioning regime, it is not therefore *necessary* to have a single body responsible for all aspects of compliance monitoring and/or licence enforcement, and, where a diverse set of skills are required, a 'single agency' model may not be the most appropriate. What is required, however, is a clear understanding of which body has responsibility in monitoring compliance in which area, and how co-ordination between the different institutions will be achieved, in terms of preventing reporting over-lap, ensuring

[29] The 'single responsibility' model does not remove the possibility of duplications and omissions, if different departments of the same agency share responsibilities.

timely exchange of information and ensuring that the monitoring of certain obligations does not 'fall through the cracks'.

The most common areas in which monitoring responsibilities are divided are between monitoring overall licence compliance, monitoring compliance with safety and technical obligations, monitoring compliance with environmental requirements and in assessing customer complaints to identify any breaches of licence obligations. Typically, co-ordination between agencies is achieved through establishing a formal Memorandum of Understanding (MOU), setting out co-ordination procedures and establishing regular contact meetings between the agencies. It is important that such MOU documents are clear and comprehensive, and are actively acted upon.

Where more than one institution is involved in monitoring compliance, it may be desirable to establish a monitoring 'hierarchy', with one institution given overall responsibility, but required to seek input from (and liase with) other institutions, in order to capture some of the benefits of the 'single responsibility' model.

3.2.6.1. Technical and safety obligations

In South Australia, separate agencies are responsible for monitoring licence compliance in the electricity and gas sectors. Under the South Australian Gas Act 1997, responsibility in the gas sector (both natural gas and LPG) for administering the licensing system, monitoring and regulating safety and technical standards and establishing and monitoring service standards lies with the Office of the Technical Regulator.[30]

In the electricity sector, the SAIIR has responsibility for licence compliance monitoring. However, the Office of the Technical Regulator is required as a condition of the Electricity Act to advise the SAIIR on the approval of safety plans submitted by licensees. The SAIIR has responsibility for approval of these plans (which are required to be submitted as a condition of businesses licences), however plans may only be approved on the recommendation of the Office of the Technical Regulator.[31] In addition, the Office of the Technical Regulator is responsible for the ongoing monitoring of safety and technical standards.

The SAIIR and the Office of the Technical Regulator both participate in the Electricity Planning and Regulators Coordination Group, with the aim of ensuring co-ordination between the functions of each institution. This group, whilst not particularly formal, meets monthly to discuss what each regulator is doing and to cover any potential areas of overlap.

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30 http://www.energysafety.sa.gov.au/about.htm

31 South Australia Electricity Act 1996, section 23(c).

3.2.6.2. Customer protection obligations

In the US, the state Public Utilities Commission ‘consumer affairs’ division receives customer complaints directly, and interacts with the commission itself on compliance and other issues. Co-ordination is therefore achieved directly through both functions being incorporated in the same body.

Elsewhere, there are formal MOUs in place between the body monitoring licence compliance and the ombudsman (or equivalent) which receives consumer complaints.

In the UK, the Gas and Electricity Markets Authority (GEMA)[32] and the Consumer Council (energywatch) are required under the Utilities Act to make arrangements for:

> “*(a) co-peration and the exchange of information between them; and*
>
> *(b) consistent treatment of matters which affect both of them.*”

GEMA and energywatch have signed an MOU,[33] which requires them to:

- hold formal joint meetings at least quarterly and to consult on forward work programmes;
- establish efficient working procedures for the handling of consumer complaints;
- review the MOU at least every two years;
- identify contact points within the two organisations to be responsible for the exchange of information;
- review at least quarterly of performance matters of general concern to consumers including: prices; change of supplier process; compliance with licence conditions; consumer complaints; standards of service; codes of practice and special services for the elderly, disabled and the chronically sick; and
- co-ordinate requests for information from licensees in order to avoid unnecessary duplication and placing undue burden on companies.

The MOU also states that ‘more detailed’ working arrangements will be derived and published.

In Victoria there is an MOU between the ORG and the Energy and Water Ombudsman of Victoria (EWOV), which covers:

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32 GEMA is the body which directs Ofgem.

33 GEMA has also signed MOU with the Health and Safety Executive and the UK Environment Agency.

- the forwarding of complaints from the ombudsman to the ORG;
- a commitment to meet monthly to discuss relevant issues, including the nature of complaints being received; and
- the provision of reports by the ombudsman to the ORG to enable the ORG to deal with systematic complaints, eg, by way of a licence or code amendment.

The SAIIR in South Australia has also entered into an MOU with the South Australian Electricity Industry Ombudsman.

3.2.6.3. Competition policy

In the UK, there are there are two separate independent agencies with responsibility for competition policy: the Office of Fair Trading (OFT) and the Competition Commission. In essence, the OFT is responsible for most aspects of competition except for mergers.

In the gas and electricity sectors, the OFT and Ofgem have concurrent powers on all aspects of competition policy, except mergers. In practice, the OFT has delegated its competition responsibilities for electricity and gas to Ofgem. However, at the point at which competition become sufficiently well established (eg, in retail functions), the responsibility for ensuring fair competition will revert to the OFT.

4. CONCERNS WITH THE CURRENT NSW ENERGY LICENSING REGIME

This section summarises concerns with the current NSW energy licensing regimes. These concerns relate both to the current administrative arrangements for licence compliance monitoring and enforcement and also the substantive content of licence obligations. Appendix A provides a fuller background on the current NSW regime.

Recommendations for addressing the concerns highlighted in this section are contained in section 5 of this report.

4.1. Administrative Arrangements

4.1.1. Non-Compliance

A previous feature of the electricity regime has been a level on non-compliance with licence conditions. In 1999/2000, approximately half of electricity licensees did not comply with various licence conditions.[34] In some cases, non-compliance followed similar breaches made the previous year. Two licensees did not submit licence plans in 1999/2000, four licensees did not submit environmental plans and six licensees did not report their performance against some or all of the required customer service performance indicators. In addition, some documents were submitted late, and some were submitted containing apparently incorrect data. We understand from IPART that there has been only one instance of reported non-compliance by electricity licensees with respect to 2000/01.

There is currently no effective monitoring or information provided on the presence or extent (if any) of non-compliance with authorisation conditions in respect of gas authorisation holders.

As noted in section 2.2, previous non-compliance with licence conditions has not lead to any significant adverse impacts on either customer protection or safety. To at least some extent this is a result of some licence conditions not imposing meaningful obligations on licensees, so that a breach (such as the failure to submit licence plans) does not have any real impact. However, as noted in section 2.2, there are a number of factors which increase the importance of ensuring effective *future* compliance with licence obligations.

4.1.2. Lack of transparency of obligations

Obligations on both electricity and gas licensees are currently spread over a large number of legislative instruments. Specifically, in order to comply with their licence/authorisation conditions, licensees have to be aware of, not only the conditions specified in their

34 See IPART's Electricity Distribution and Retail Licences Compliance Report for 1999/2000.

licensees/authorisations, but also any regulation conditions which are also licence conditions, obligations arising under Market Operation Rules, obligations under the Marketing Code of Conduct, obligations contained in various guidelines and (for electricity licensees) obligations under Codes of Practice. Licensees have commented they are not clear on what the requirements of the regimes are and that licence conditions should be simple and unambiguous.[35]

The lack of transparency which currently characterises the regime may act as a barrier to entry for new businesses in the competitive retail markets for both electricity and gas. It is also likely to add to compliance costs, as both licensees and IPART have to review a large number of instruments in order to understand the extent of the obligations licensees are required to comply with. The lack of transparency also makes it easier for conflicting or duplicate obligations to arise (see section 4.2.1).

4.1.3. Monitoring and reporting

There are a number of shortcomings with the current licence monitoring and reporting requirements.

Currently, compliance monitoring is carried out through an annual process of reporting and assessment, conducted in arrears. Electricity sector licensees are required to submit compliance reports to IPART by the end of August, which cover compliance in the previous financial year. Gas sector licensees are required to submit more limited compliance information by the end of September, with respect to the previous financial year.

Reactive annual compliance monitoring of this type obviously cannot be used to actively *prevent* breaches of requirements (unless the penalties for non-compliance are so great that the licensee avoids potential breaches at all costs). It also limits the speed with which breaches of licence obligations are detected and can be acted upon. This delay may, in turn, increase the impact of the breach and/or the costs of correction. In particular, a delay of a year in the detection of the breach of licence conditions relating to consumer protection (such as the compliance with the Marketing Code of Conduct) will not effectively ensure that customers receive the intended protection from those licence conditions. Indeed, this has been commented on by licensees themselves.[36]

To the extent that there are other avenues to ensure that the breach of customer protection provisions are picked up more quickly (such as EWON receiving customer complaints and reporting suspected breaches to the Minister), licence compliance monitoring then ceases to be the main tool through which breaches are identified. In these circumstances, the rationale

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35 See Integral's submission to the Issues Paper; see also PIAC's submission to the Issues Paper.

36 See submissions in response to the Issues Paper from NSW distributors (combined submission) and Australian Inland Energy and Water.

for such breaches also being monitored annually by IPART is called into question and may represent unnecessary duplication.

In addition to the frequency of compliance monitoring and reporting, the form of reporting also amounts to a shortcoming of the current regime.

IPART has introduced a reporting pro-forma for electricity licensees, which standardises reporting requirements. Compliance assessment under this pro-forma is currently on the basis of 'yes/no' responses to the question of whether the licensee has complied with each licence condition. There is no focus of monitoring on particular obligations, and no differences in the way in which compliance with different conditions is monitored. A 'yes/no' approach is unlikely to be the most effective way of monitoring compliance with all licence obligations.

No equivalent reporting pro-forma exists for gas licensees. The lack of a standardised reporting format means that compliance costs are potentially increased, both for licensees in having to double-guess what information is required and for IPART in sifting through differing reports for the information it considers relevant. However, in practice, the compliance assessment conducted to date in the gas sector has been much more limited, and focused only on financial information.

In addition, the procedure currently surrounding alteration of reporting requirements for licensees is not clear. Reporting requirements have previously been subject to change, often retrospectively. Licensees report frustration with such changes and with what they perceive to be limited input into the process for change. Frequent changes to reporting requirements increases licensees' compliance costs, since they result in licensees having to change their internal business procedures in order to comply with new reporting requirements.

In the electricity sector, licensees are required to have their responses in their compliance reports assessed by an independent appraiser. There have been guidelines issued for the conduct of independent appraisals.[37] However, within these guidelines the scope for variations in the quality and approach to assessment, and even the coverage of the assessment, is still significant. Such appraisals stop short of being an independent audit.

Finally, in both the gas and electricity sectors there are currently requirements to provide a number of reports, the value of which is, at best, questionable. In the case of electricity licensees, they are required to submit 'licence plans', which cover the approach the business intends to take in a number of areas, such as complaint management and customer service. There is no approval process associated with the submission of such plans, and compliance is achieved through the submission of a plan, rather than a specified outcome. (Licence plans are discussed further in section 4.2.2 below.) In the gas sector, licensees currently

[37] Minister for Energy, Guidelines for Independent Appraisals of Electricity Distribution Network Service Providers' and Retail Suppliers' Licence Condition Compliance Annual Reports, June 2001.

submit Consumer Safety Awareness Plans and Energy Efficiency Strategies, for which, again, there is no approval process and in relation to which no further action is currently taken.

4.1.4. Roles of different institutions

Licensees have commented that there is a lack of transparency in the delineation of responsibilities between agencies (specifically IPART, Ministry of Energy, the Department of Fair Trading and NSW Treasury) with respect to licence compliance monitoring and reporting requirements.[38]

Licensees may be required to report to some agencies on certain aspects of their business, which are also the subject of licence provisions. For example, one of the areas covered by the Network Management Report which electricity network businesses submit to the Ministry of Energy, is reporting on alternatives distributors have considered to distribution system augmentation. Such information is also relevant for monitoring compliance with the condition in distributors' licences which requires them to consider demand management alternatives before augmenting their network. As a result, IPART requires similar (if not identical) information in monitoring licence compliance as the Ministry receives in relation to network performance.

Similarly, the Ministry of Energy and Utilities has the key role in assessing and monitoring safety for both electricity and gas network businesses, under the relevant regulations. However, there are also a number of licence conditions, particularly in relation to the natural gas reticulators authorisation, which relate to safety, and so therefore fall under IPART's licence compliance monitoring jurisdiction.

In addition, the new regulations in electricity and gas introduce a number of new customer protection provisions, compliance with which is required as a licence condition. However, a breach of these conditions is likely first to become evident through customer complaints received by EWON. EWON has an obligation to advise the Minister as soon as it is aware of a licence breach or a breach of the Marketing Code of Conduct. IPART's role in monitoring licence breaches of this type is therefore potentially unclear. In addition, breaches of these licence conditions may also constitute breaches of Fair Trading legislation and therefore may potentially also be investigated by the Department of Fair Trading.

To the extent that there is the potential for duplication or over-lap between the roles of different agencies, ensuring that roles are effectively co-ordinated will both ensure that all relevant obligations are monitored (through clearly assigning responsibility between agencies) and will reduce the costs of compliance monitoring, from both a government and licensee perspective.

38 See Integral's submission to the Issues Paper.

4.1.5. Lack of enforcement

To date, the powers of enforcement available to the Minister and to IPART with respect to licence compliance have not been used, despite instances of non-compliance occurring. In part, this is likely to be because (as noted in 4.1.1 above) the instances of non-compliance have not been in relation to significant obligations. However, the fact that the licensing regime has not been enforced to date is a factor which undermines the credibility of the current regime, and therefore makes licence breaches more likely.

In addition, there are now a number of routes via which penalties for certain actions may be enforced. The Electricity and Gas Supply Acts allow the Minister to impose penalties of up to 200 penalty units (currently $22,000) for a breach of the Marketing Code of Conduct or a breach of the Market Operation Rules.[39] For electricity retailers, the Electricity Act also allows the Minister to impose a fine of 100 penalty units (currently $11,000) on a retail licensee for breaching obligations under the Electricity Tariff Equalisation Fund (ETEF).[40] In addition, since compliance with the Marketing Code of Conduct, Market Operation Rules and ETEF are all licence obligations, rather than a penalty being imposed under the powers of the Acts, a breach could also be sanctioned by a licence compliance penalty imposed by either IPART or the Minister.[41] As a result, there is a lack of transparency about what penalties may apply for a breach. This in turn may undermine the credibility of the enforcement regime.

4.2. Substantive Content of Licence Obligations

4.2.1. Duplication and inconsistency in obligations

The current regime is characterised by a degree of duplication and inconsistency between obligations on licensees.

When the energy licensing regime in NSW was initially established, it was driven by the philosophy the regime should be one of ‘self-regulation’ as far as possible. As a result, licensees were given considerable discretion to determine customer service standards and to collectively develop Codes of Practice covering various aspects of licensees’ behaviour. This philosophy is reflected in the current electricity licence condition for licensees to develop their own ‘licence plans’, governing aspects of their behaviour.

Over time, the legislative regime has become more prescriptive, in terms of the obligations placed on licensees. For example, a number of regulations now place specific obligations on licensees in areas where previously licensees were left to develop their own policies, most notably the most recent Electricity (General) Regulation, and the new Gas (Natural Gas

[39] Electricity Supply Act 1995, section 63D and 63H, Gas Supply Act 1996, section 33O and section 33L.

[40] Electricity Supply Act 1995, Condition 43 EP.

[41] IPART may impose a maximum penalty of $10,000, plus an additional $1,000 per day that a breach is not rectified. The Minister can impose a maximum penalty of $100,000 (Electricity Supply Act 1995, schedule 2, 8(1)(a))

Retail Competition) Regulation. In electricity, there has also been the introduction of specific obligations under the National Electricity Code, as a result of NSW being part of the wider NEM, which have superseded previous self-regulation (for example, the Franchise Customer Metering Code) or impose obligations which duplicate existing licence obligations. However, the increase in prescriptiveness has not been reflected in an updating of the licensing regime. As a result, in a number of areas licensees now face conflicting or duplicate obligations, or face obligations which are now redundant.

As an example of such duplication, natural gas reticulators and LPG distributors are required under the Gas Supply (Safety and Operating Plans) Regulation 1997 to submit safety and operating plans to the Director of the Ministry of Energy and to conduct their business in accordance with these plans. However, at the same time there are also a number of safety-related conditions in both businesses licences, which appear to be redundant, in the light of the requirement to submit and to operate in accordance with a Safety and Operating Plan.

A further example of the duplication of obligations is the electricity distributor licence condition which requires distributors to consider demand management alternatives before augmenting their distribution networks.[42] The NSW Demand Management for Electricity Distributors Code of Practice provides guidance on implementing this licence condition.[43] The condition is, however, now duplicated under the National Electricity Code,[44] which in fact goes further in requiring that distributors consider alternatives to the expansion of the distribution system, including embedded generation as well as demand management, and sets out the process that distributors are required to follow in assessing such alternatives.

Obligations which now appear redundant, as a result of the move towards greater prescription in obligations include the current requirement on electricity licensees to submit 'licence plans' (see section 4.2.2 below).

As an example of inconsistent obligations, there are currently three electricity industry Codes of Practice which either have been superseded by more prescriptive regulatory requirements, or are about to be superseded. These are the Customer Transfer Code, the Retailer of Last Resort Code and the Franchise Customer Metering Code.

The Customer Transfer Code is listed on the Electricity Association of NSW's (EANSW) website as "currently in operation". However, provisions for customer transfer are now covered by a Market Operation Rule and also NEMMCO customer retail transfer procedures. Similarly, the Electricity (General) Regulation 2001 requires retailers who hold

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42 This condition is one which is *required* to be included in distribution licences under the Electricity Supply Act 1995 (Schedule 2, 6(5)(a)).

43 NSW Demand Management for Electricity Distributors Code of Practice, May 2001, recognised by the Director-General of the Ministry of Energy and Utilities on 1 August 2001.

44 National Electricity Code Section 5.6.2.

an endorsement as a retailer of last resort (ROLR) to prepare and maintain a ROLR plan, which must be approved by the Minister.[45] The Minister is expected to have approved ROLR plans prior to the start of 2002, effectively replacing the obligations in the Retailer of Last Resort Code. The Franchise Customer Metering Code will eventually be replaced by a Market Operation Rule which is currently being drafted (and is expected to be in place prior to the start of 2002) and the metering requirements in the National Electricity Code.

Although, in practice, retailers no longer comply with the Code of Practice obligations, there is currently no formal mechanism to indicate clearly that such Codes are no longer applicable.

Duplication between obligations potentially increases monitoring costs and the costs of compliance, in the absence of effective co-ordination between agencies. It is inefficient to have businesses reporting the same, or even different, information to different monitoring agencies, relating to the monitoring of the same aspects of behaviour. Obligations which are redundant also increase the costs (and undermine the credibility) of the compliance regime, since information is reported which is not required. Conflicting obligations undermine the credibility of the licensing regime itself, since licensees *cannot* comply with all obligations.

4.2.2. Licence Plans

Electricity licensees are required as a condition of their licence to submit 'licence plans' and to report on performance against these plans.[46] (There is no equivalent to these plans under the gas authorisation regime.)

The requirement for licensees to submit licence plans arose as part of the earlier philosophy that the licensing regime should be one of self-regulation as far as possible. The requirements of licence plans are set out in the Ministerial Guidelines and Requirements Policy, and broadly cover:

- measures to be implemented by electricity distributors to protect persons and property;
- standards of service, including key performance indicators and guaranteed service levels;
- plans for complaint management;
- plans for licence compliance management; and

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45 Electricity Supply (General) Regulation 2001, clause 58.

46 See section 3.7 of both the Electricity Distributor's Licence Conditions and the Electricity Retail Supplier Licence Conditions.

- participation in development of guidelines.

Licence plans are not ‘approved’ and licensees may vary the plan retrospectively once actual performance is known. Each business can use its discretion on the form of reporting it uses and also the method it uses to gauge compliance.

Licensees themselves have expressed a frustration with not knowing what they should include in the plans and the onerous and convoluted nature of the reporting requirements.[47] In its submission to IPART’s Issues Paper, the Public Interest Advocacy Centre (PIAC) commented:

> “a system where licensees devise their own service standard levels and amend these unilaterally is far from satisfactory. The current system lacks accountability and consistency. The move towards better defined standards and uniform reporting of performance against those standards is an essential feature of an improved licensing regime.”

The submission of licence plans seems at odds with the move towards a greater degree of prescription in relation to the matters currently covered by the licence plans. In particular, customer protection requirements and guaranteed service levels are now mandated under the Electricity (General) Regulation 2001. The submission of licence plans also does not seem to impose meaningful obligations on businesses, since there is no requirement for the plan to be approved, or for a particular outcome to be achieved. The presence of this licence condition therefore appears to increase reporting and compliance costs, for no tangible benefit.

4.2.3. Minimum standards

Currently, electricity sector licensees are required to meet certain minimum standards for customer service, known as Guaranteed Service Levels (GSLs).[48] There are currently no minimum standards set for electricity network performance. The gas licensing regime does not contain any equivalent minimum standard requirements, for customer service or system performance.[49]

Table 4.1 sets out the current minimum standards applying in the electricity sector.

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[47] See Integral Energy submission to the issues paper.

[48] The GSLs are set out in the Electricity Supply (General) Regulation 2001, schedule two, part two, and schedule three, part two.

[49] It should be noted that safety obligations themselves imply a ‘floor’ on performance standards, for both electricity and gas businesses. The Minimum Standards discussed in this section relate to performance which exceeds this safety floor.

Table 4.1
Guaranteed Service Levels applying to Electricity Retail Licensees and DNSP Licensees

Service Standard	Payment
Licensee more than 15 minutes late for an appointment	$25
Late connection	$60 a day, up to $300
Interruption to supply without 2 days prior notice, or for longer than the duration indicated in the notice	$20
Failure to repair street lights by date agreed	$15

Source: Electricity Supply (General) Regulation 2001, Schedules 2 and 3.

Current minimum standards are in some cases neither meaningful nor relevant to key customer concerns. For example, if a retailer is more than 15 minutes late for an appointment with a customer, the retailer must pay the customer compensation of $25.[50] However there is no corresponding obligation on retailers to set a specific appointment time. As a result, retailers are able to avoid having to pay compensation under GSLs by setting broad appointment times. Indeed, customers may suffer *greater* disruption as a result of the GSL, to the extent that licensees only make appointments within wide time bounds. Data submitted to IPART shows that the total compensation paid to customers by electricity licensees as a result of a failure to meet this GSL in 2000/01 was $75. PIAC commented in its submission to IPART's Issues Paper[51] that community and consumer representatives did not support retaining this standard, as it has little practical meaning for customers and is unable to be enforced.

In addition, customers need to apply for most GSL compensation payments from most electricity licensees, rather than such payments being issued automatically. Retailers are not under an obligation to inform customers when they are due a specific compensation payment, although they are obliged under the Electricity (General) Regulation to advise customers in general of the existence of GSL payments and in what circumstances customers can claim these payments.

4.2.4. Performance indicators

Electricity licensees are currently required to report against a number of specified 'key performance indicators' (KPIs) as part of the annual licence compliance reporting framework. As with minimum standards, there are no equivalent KPI requirements established for gas licensees.

The current policy rationale for reporting on KPIs is not clear. As such, it is difficult to judge the extent to which the current KPIs are appropriate, in order to meet policy objectives. Possible policy rationales are discussed further in section 5.4.5.

50 Electricity Supply (General) Regulation 2001, schedule two, part two, p89

51 See PIAC submission to the Issues Paper, pps 8-9.

Licensees have questioned the relevance of KPIs and feel that they are ill defined and misaligned with licensing objectives. The KPIs are seen as being impractical, expensive to capture and not always controllable by the licensee. As a result, licensees have called for a reduction in the KPIs they are required to report on, and a greater alignment with licensing objectives.[52]

4.2.5. Environmental reporting

Licence conditions relating to the environment for both electricity and gas are limited to a requirement to develop 'strategies'.[53] As such, compliance by licensees need not result in a specified outcome. Rather, licensees have complied with their licence obligations once they have submitted a strategy.

Electricity retail licensees must develop strategies for reducing greenhouse gas emissions from electricity supplied to customers. They must submit a report on performance on the implementation of the strategies for audit by the NSW Environmental Protection Agency (EPA), at least once every three years. The only standard requirement is that the strategies must include a target greenhouse gas emission level, against which performance must be independently measured. However, licensees are not penalised for failure to meet these targets, and out-performance of targets is not rewarded.

Natural gas suppliers supplying gas in excess of 100 terajoules annually must develop and implement strategies to promote the adoption of thermally efficient gas appliances and efficient energy-use practices. However, as in the case of electricity licensees, there are no penalties for failure to achieve certain outcomes.

The current licence conditions were imposed at a time when the focus of the licensing regime was one of allowing self-regulation where possible. As such, the public reporting against self-imposed environmental targets was expected to provide an incentive for licensees to meet those targets. However, the fact that targets have not been achieved means that the effectiveness of current license obligations in meeting environmental policy objectives must, at best, be viewed as questionable.

52 See Integral, PIAC, Australian Inland Energy and Water and Distribution Network and Standard Retail Service Providers submission to the Issues Paper.

53 See section 3.3 of the Natural Gas Supply Authorisation and section 3.1 of the Electricity Retail Supplier Licence.

5. RECOMMENDED FRAMEWORK FOR NSW

5.1. Introduction

Under the Terms of Reference from the Minister, IPART has been requested to make recommendations on improvements to the energy licensing regime which would improve compliance of licensed businesses with existing government policy.

Improving compliance with existing government policy objectives can be achieved in two ways:

i. by increasing the extent to which licensees comply with the licence conditions placed on them; and

ii. by increasing the extent to which licence conditions reflect government policy objectives.

In order to achieve the greatest overall improvement in compliance of licensed businesses with existing government policy objectives, it is therefore important to focus on making improvements in *both* of these areas, whilst being mindful of the costs associated with the compliance framework.

In the review of shortcomings in the NSW licensing framework in Section 4, we noted that there are a number of shortcomings with respect to the administrative arrangements for monitoring and enforcing licence compliance, as evidenced by previous instances of non-compliance. We also noted that some current licence conditions do not place meaningful obligations on licensees.

There is therefore scope to make changes to administrative arrangements so that licensees are better aware of their obligations and a higher degree of compliance with licence conditions is achieved. However, an improvement in licence compliance will only bring a limited benefit, if the meaningfulness of the licence conditions themselves is not improved. Similarly, making changes to licence conditions so that they do place more meaningful obligations on licensees, which better reflect government policy, will only bring limited benefits, if steps are not taken to ensure improved compliance with those licence conditions.

Our recommendations for a more effective model for the NSW energy licensing regime therefore encompasses recommendations on improvements to the administrative arrangements, so that the monitoring and enforcement of compliance is more effective, and also recommendations on changes to the substantive content of the licence conditions themselves.

5.2. Administrative Arrangements

This section sets out our recommendations for improving the administrative arrangements in the NSW energy licensing regime, in order to achieve greater compliance with government policy objectives. It should be stressed that the recommendations below provide a framework. In Part 2 of the consultancy project, NERA will further develop these recommendations in order to arrive at a compliance monitoring and reporting framework which IPART can implement, to discharge its role as NSW licence regulator.

5.2.1. Improving the transparency of obligations

Improving the transparency of the current obligations on licensed businesses would be a key step in making the regime more comprehensible, especially to new entrants in the retail market, therefore removing a potential barrier to entry. It would also enhance the credibility of the regime, by demonstrating that IPART (as licence regulator) is actively aware of all obligations and will be monitoring compliance with those obligations.

An improvement in transparency could be achieved through issuing a form of ‘consolidated licence’, which contains all obligations applicable to licensees. However, in the electricity and gas sectors, such a licence is likely to be unwieldy, given the large number of obligations on licensees.

Rather, our recommendation is for Consolidated Reference Documents to be prepared and published in relation to each licence, eg an Electricity Retail Consolidated Reference Document; an Electricity Distribution Consolidated Reference Document; a Natural Gas Reticulation Consolidated Reference Document; a Natural Gas Supply Consolidated Reference Document; and an LPG Distributor Consolidated Reference Document. These Consolidated Reference Documents would in turn set out a comprehensive list of all obligations imposed on licensees, both as direct licence conditions and as licence conditions under Acts and regulations (together with a comprehensive list of all relevant documentation for where the obligation arises, eg, specific regulation, code of practice, etc). As such, the Consolidated Reference Documents would be similar in role and coverage to the Electricity Retail and Distribution Codes issued in South Australia.

The advantage of issuing Consolidated Reference Documents pursuant to a shorter licence is that the Consolidated Reference Documents can be amended as associated documents change (such as Regulations) without requiring an amendment to the associated licence. Such an arrangement is likely to be administratively simpler (see below).

In the electricity sector, the Consolidated Reference Documents should build on the current Ministerial Guidelines and Requirements Policy document issued under the electricity licences. In comparison with the current Ministerial Guidelines and Requirements Policy, the focus of the Consolidated Reference Documents should be more on direct requirements (ie, the obligations on licensees and what licensees are required to do in order to be taken to have complied with each obligation - the type of information currently summarised in the 'boxes' in the Ministerial Guidelines and Requirements Policy), rather than the more discursive 'context and development' sections of that document.

In the gas sector there is a need to prepare Consolidated Reference Documents from scratch, as there are no current documents which could be used as a base (with the exception of the Guidelines for Compliance with Environmental Conditions issued is relation to the Natural Gas Supplier's Authorisation).

It is important that the Consolidated Reference Documents are 'living' documents, and are updated in the light of any changes to obligations. Such updating should include any changes to subsidiary legislative instruments or codes of practice which contain obligations that the licensees are required to comply with. This ensures that the current status and applicability of such documents is clear.

Under the current institutional and legislative framework, the Consolidated Reference Documents would be approved and issued by the Minister. However, rather than have the Minister approve and issue each updated version of the Consolidated Reference Documents, it may be more appropriate from an administrative perspective to have the initial Consolidated Reference Documents prepared by IPART and approved and issued by the Minister, together with a direction from the Minister to IPART to ensure that the Consolidated Reference Documents documents are kept up to date, as this is largely an administrative function.

In the first instance, the Consolidated Reference Documents should *not* reference the Customer Transfer to Retailer of Choice Code. Once the Minister has approved ROLR plans (expected before the end of December 2001), and the new Market Operation Rule covering metering requirements (also expected before the end of December 2001), the Consolidated Reference Document should also not reference the Last Resort Supply Code and the Franchise Customer Metering Code. This would be a means of clarifying when compliance with these codes of practice (or explanations of why licensees have not complied with these codes of practice) is no longer required.

In order to allow licensees to gauge the current status of the Consolidated Reference Documents, they should clearly state the version number and the date of the last revision.

5.2.2. Administration of licences

It seems clear that there is a role as part of the process of issuing licences to avoid significant disruption arising from later breaches of licence conditions, through establishing a number of thresholds which potential licensees are required to meet. These thresholds would be administered by IPART in recommending to the Minister when licences should or should not be issued. The thresholds themselves would need to be sanctioned by the Minister, through the approval of a guideline on licence applications.

The first of these thresholds is an adequate level of financial resources.[54] Establishing a minimum financial requirement as a condition of being issued with a licence (and therefore as a condition of entry into the market) means that it is possible to 'screen out' businesses which do not have sufficient financial backing to operate successfully in the market, ie, those cases where it is highly likely that the business would be forced to exit within a short time. This is particularly relevant for new entrant retail licensees, in the newly competitive electricity and gas retail markets. We note that several US states have introduced financial entry requirements for new electricity retailers, for just this reason. However, it is also important that the licensing regime does not 'prejudge' business success, and exclude from the market potentially successful competitors. As a result, the threshold entry requirement should be set at a level which is not unduly onerous.

In the electricity sector, retail licences currently contain a requirement for the licensee to hold a wholesale trader's authorisation in the NEM.[55] As a result, licence applicants must demonstrate on their application form that they are registered with NEMMCO. In order to be registered with NEMMCO, retailers must demonstrate that they meet a pre-established acceptable credit criteria, or holds a bank guarantee or letter of credit from an institution that meets the necessary credit criteria. As a result, the requirement to be registered with NEMMCO, in effect, represents a financial 'entry' hurdle for new licensees.[56]

There is currently no equivalent 'entry hurdle' for new retailers in the gas sector. Our recommendation is that consideration should be given to establishing a financial entry hurdle for gas retailers.

In addition to the need to meet a financial hurdle, assessing the ability of a potential licensee to comply with licence obligations at the time at which a licence is issued, can also prevent later non-compliance, and the associated costs of that non-compliance. Currently licensees in the electricity sector are required to demonstrate as part of their licence application that they 'understand, and will be able to satisfy, the compliance obligations imposed under a retail supplier licence.'[57] We are not aware of an equivalent requirement for applicants for a gas retail licence.

In order to increase the effectiveness of this application requirement, we recommend that consideration be given to the need for potential licensees in both the electricity and gas sector to be required to demonstrate *ex ante* the adequacy of the compliance systems they have in place, for meeting key licence conditions. Such *ex ante* demonstration would relate

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54 The discussion in this section relates to financial 'hurdles' prospective licensees are required to meet. Section 5.4.3 discusses the appropriateness of on-going prudential monitoring.

55 Electricity distribution licences contain an equivalent requirement for the licence-holder to hold a network operator's authorisation.

56 We note that the licence requirement to hold NEM registration is an on-going one, and not limited to an 'entry-only' criteria. We discuss the role of *on-going* financial prudency requirements in Section 5.4.3.

57 Independent Pricing and Regulatory Tribunal , Application Form for an Electricity Retail Supplier Licence, Point 7.

to the presence of documented business processes in relation to specified licence conditions. This recommendation is in line with our recommendation for on-going *ex ante* compliance monitoring (see section 5.2.3 below). Specifically, the application process for new licensees should require an *ex ante* demonstration that compliance processes are in place for the same licence conditions as those for which we have recommended *ex ante* demonstration of compliance for existing licensees.

Such an *ex ante* assessment of compliance for new licensees would be consistent with entry conditions in other industries. For example, in the airline industry, CASA requires that applicants are either aware of, or have written procedures for each applicable regulatory provision before being granted an aviation certificate. Regulatory provisions are specifically graded to reflect whether the requirement is to be aware of a certain provision, or to have a written compliance procedure in place to ensure that that provision is met. Whilst the precise requirements which CASA imposes on new applicants exceeds what is likely to be required in the electricity and gas retail sectors, the principle of identifying key obligations for which the applicant has to demonstrate documented compliance processes matches our recommendation.

5.2.3. Compliance monitoring

A key factor in achieving improved compliance with government obligations is a more appropriate compliance monitoring framework.

Currently compliance monitoring by IPART is conducted only on an annual basis, following the end of the financial year for which compliance is being assessed. Moreover, whilst there is a developed framework for compliance monitoring in the electricity sector there is no such framework established for the gas sector.

There is a clear need for a compliance monitoring framework to be developed for gas sector licensees. The current absence of an explicit compliance monitoring framework means that there is no clear picture of the extent to which licensees do comply with their licence conditions. In an environment where there is a move towards the introduction of more prescriptive obligations (particularly the introduction of more prescriptive customer protection obligations via the new Gas Supply (Natural Gas Retail Competition) Regulation), the absence of an explicit compliance monitoring framework undermines the credibility of the new obligations.

In addition, the changes in the nature of the obligations on licensees means that the current annual monitoring conducted by IPART will not be effective in detecting breaches in a timely manner. In particular, with the advent of retail competition and the introduction of new licence conditions relating to customer protection, the current licence monitoring arrangements will not be effective in detecting breaches of licence conditions when they occur. Rather, any breaches by electricity licensees over the period from July 2001 to June 2002 would only be detected via the current licence compliance monitoring arrangements when licensees submit their licence compliance reports in September 2002. Moreover, given that there are currently no reporting conditions for gas licensees with respect to compliance with customer protection provisions, breaches of customer protection provisions by gas licensees would not be detected at all via the licence compliance monitoring process!

In reality, in the absence of changes to the current licence compliance monitoring regime, the brunt of the detection of any breaches in customer protection provisions is likely to be borne by EWON, via the customer complaints it receives. EWON has an obligation under both the Electricity Supply Act and the Gas Supply Act to inform the Minister for Energy of any suspected licence breaches or breaches of the Marketing Code of Conduct. However, it needs to be considered whether EWON is the most appropriate agency to be in the forefront of compliance monitoring for customer protection provisions. We discuss the roles of different agencies further in section 5.3. If it is decided that EWON should perform this role, then there needs to be coordination between this monitoring function and any monitoring undertaken by IPART as part of the license compliance regime.

In addition, although the majority of breaches of customer protection provisions are likely to come to light as a result of complaints to EWON, cases where customers complain to licensees but do not take their complaints further, or cases where breaches are brought to light through, for example, media investigations, can easily be envisaged. In this case, annual monitoring of licence compliance by IPART would again play no role in bringing such breaches to the attention of the Minister, until up to eighteen months after the event, at best.

It would appear more effective to retain the monitoring of customer protection obligations under the licensing regime, rather than diluting responsibility for monitoring between different agencies (see discussion in section 5.3). However, it is important to recognise that effective monitoring of some licence conditions will require changes to the current annual reactive monitoring undertaken by IPART.

In particular, there are licence obligations for which compliance monitoring should instead involve a degree of *ex ante* assessment of the compliance systems which licensees have in place, in order to prevent breaches occurring in the first place. There are also conditions for which more frequent reactive monitoring (such as monthly or quarterly) should be undertaken, in order to be able to identify breaches more quickly and undertake effective enforcement action.

As a result, our recommendations are that compliance monitoring should be tailored, based on the nature of the licence condition and the implications of a breach. In particular, all obligations on licensees should be classified as being of one of the following types:

- **Type 1**: an obligation for which *ex ante* assessment of compliance processes should be conducted;
- **Type 2**: an obligation for which frequent *ex post* compliance monitoring should be conducted; or

- **Type 3**: an obligation for which annual *ex post* compliance monitoring should be conducted.

Compliance reporting requirements will differ depending on whether an obligation is a Type 1, Type 2 or Type 3. In particular, the content of required reporting may differ as well as the frequency, particularly between Type 1 *ex ante* compliance assessment and Type 2 and 3 *ex post* reporting.

It is our understanding that there is nothing in the primary legislation which limits IPART's monitoring role to only being undertaken on an annual basis. Whilst the Electricity Supply Act requires IPART to report to the Minister for Energy on an annual basis,[58] it does not restrict IPART from monitoring compliance more frequently, or from submitting additional, more frequent, compliance reports to the Minister. However, in order to have access to information from licensees on a more frequent basis, IPART is required to request such information from the Minister.[59] Each of the energy sector licences contains a condition (imposed by the Minister) that licensees are to provide to the Minister (or to the Director of the Ministry of Energy) any such information which the Minister (or the Director) requests, in order to determine whether the licensee is complying with its licence conditions.[60]

It is also important that in adopting targeted monitoring, IPART does not take on a policy role, for example through choosing not to monitor certain obligations. Our recommendation is that all obligations are monitored at least annually. In addition, the Minister would approve the initial Reporting Manual (see section 5.2.4.1), which would include a classification of all obligations as either Type 1, 2 or 3. Part of this approval should relate to a confirmation that the compliance monitoring adopted by the IPART is consistent with the government's policy objectives.

In the remainder of this section we discuss criteria for determining whether a licence conditions should be classified as requiring Type 1, Type 2 or Type 3 monitoring, and provide examples of the types of licence obligation which would fall into each category.

It should be noted that the classification of conditions as either Type 1, Type 2 or Type 3 should be able to be changed, as appropriate, for example, following suspected breaches of conditions.

[58] Electricity Supply Act, Division 3, Clause 88.

[59] Electricity Supply Act, Divisions 3, clause 87(2).

[60] Electricity Retail Supplier Licence condition 3.4.3; Electricity DNSPs Licence condition 3.9; Natural Gas Supplier Authorisation condition 3.1; Natural Gas Reticulator authorisation condition 8(2)(a)' LPG Licence, condition 7(2).

5.2.3.1. Type 1: Ex ante compliance monitoring

In identifying which of the current obligations on licences should be identified as requiring Type 1 *ex ante* monitoring, consideration should be given to:

- whether breaches of a licence condition are likely to have severe adverse impacts on safety or customer protection; and
- whether there are significant costs associated with correcting a breach once it has occurred, and whether such costs would be incurred by people other than the licensee.

The most obvious example of a Type 1 licence condition would be conditions relating to safety. For example, a breach of licence conditions relating to safety which resulted in an explosion of a gas pipeline would have a severe impact on both people and property in the vicinity of the explosion, and also on-going impacts on relation to the disruption of gas supplies and the consequent impact on businesses and consumers using gas.

Currently, safety obligations are already subject to *ex ante* compliance monitoring, albeit conducted by the Ministry of Energy rather than IPART, through the assessment and approval of Safety and Operating Plans.

Examples of other obligations for which *ex ante* compliance monitoring may be appropriate are a licensees' ability to comply with the obligations in relation to standard customer contracts, billing obligations and Market Operations Rules governing customer transfer. Whilst the impact of a breach of any of these provisions is arguably not as stark as a breach of safety provisions, nevertheless breaches would have a significant impact on customers and would also adversely affect customer's confidence in the new retail market arrangements. Standard customer contracts themselves embody significant customer protection provisions. A failure to comply with obligations in relation to standard customer contracts will therefore have an impact on customers which goes wider than the issuing of a contract. Likewise, failure to comply with billing obligations (resulting in customers being billed incorrectly) or the Market Operation Rule governing customer transfer (resulting in customers being transferred against their wishes) could also have an adverse impact on customer confidence in the new market.

In the case of the above conditions, *ex ante* assessment of compliance processes would cover an assessment that the licensee has appropriate business processes in place to ensure compliance with the licence condition, that these processes are adequately documented and an assessment that relevant staff are both aware of the process and could be expected to comply with it. In relation to obligations connected to the introduction of FRC (such as the adequacy of billing systems to meet obligations), such an *ex ante* assessment could also draw on the 'market readiness' assessments being conducted for the Market Implementation Group (MIG).

Such *ex ante* compliance assessment, whilst not guarding against deliberate breaches, would help to minimise the extent that obligations were breached 'inadvertently' through the presence of an inadequate compliance process.

5.2.3.2. *Type 2: Frequent ex-post monitoring*

In identifying which of the current obligations on licensees should be identified as requiring frequent *ex-post* monitoring, consideration should be given to:

- whether breaches of a condition are likely to have a high (rather than severe) adverse impact on safety or customer protection;
- whether the costs associated with the impact of the breach and/or the costs of correction are significantly lessened by earlier detection of the breach;
- whether non-compliance with the obligation is suspected; and
- whether more frequent reporting is necessary to meet the *objective* of the licence obligation (eg, quarterly comparison reporting of retailer KPIs – see section 5.4.5 below[61]).

In the case of conditions for which *ex ante* compliance assessment is required, frequent *ex post* monitoring is also likely to be required, in the event that breaches do occur and need to be identified as soon as possible.

There are also other conditions for which more frequent monitoring is appropriate. As an example, especially in the earlier stages of full retail competition, monthly or quarterly reporting against customer protection obligations is likely to be warranted in order to ensure that the new arrangements are working effectively. These provisions include the obligations included in the Electricity (General) Regulations and the new Gas (Natural Gas Retail Competition) Regulations, together with the Marketing Code of Conduct and the Market Operation Rule governing customer transfer.

The decision as to the appropriate frequency of monitoring (ie whether quarterly, monthly or even more frequently) will depend on an assessment of the additional benefits from earlier detection versus the costs of undertaking more frequent monitoring (for both licensees and IPART). The decision as to the appropriate frequency may also change over time. For example, monthly monitoring of customer protection obligations may be appropriate following the initial introduction of full retail competition. However, to the extent that no significant problems emerge, it may be appropriate for monitoring frequency to fall to quarterly after the initial six month period.

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61 We note that AGL has reported to IPART that it currently collects some compliance data on a quarterly basis. As such, a change to more frequent compliance reporting may not pose a significant additional cost to licensees. The issue of the cost of more frequent reporting will be discussed further as part of Stage 2 of the consultancy project.

5.2.3.3. *Type 3: Annual ex post monitoring*

Finally, recognising that there are costs associated with more frequent monitoring, there remain those conditions for which *ex post* annual monitoring remains appropriate. These are the conditions for which:

- breaches have little or no adverse impact on safety or customer protection; and
- early detection does not significantly increase the impact of the breach or the cost of correction.

For example, current licence conditions requiring the submission of environmental plans and strategies would continue to be monitored on an annual basis.

5.2.3.4. *Ad-hoc monitoring*

In addition to the above tailored regular compliance monitoring, IPART should also have the ability to undertake ad-hoc investigations if a significant breach of licence obligations is suspected. Such a pro-active, investigative approach would allow IPART to respond to a situation such as widespread customer slamming which comes to general attention through the media, and to inform the Minister of whether such a breach has occurred, rather than waiting for the next scheduled monitoring exercise.

Under the current legislative arrangements, IPART does not have the power to request additional information from licensees in order to conduct an ad-hoc investigation. Rather, IPART would need to make the need for the information known to the Minister, and the Minister would need to decide to request the additional information. A more pragmatic alternative may be to extend IPART's powers to request information directly, although this would require a change to primary legislation.[62]

An alternative would be for IPART to inform the Minister on an ad-hoc basis where there is a suspected breach, and for the Minister then to decide whether further investigation is warranted and who the investigation should be conducted by.

5.2.4. Reporting requirements

5.2.4.1. *Reporting Manual*

To address the current shortcoming in the NSW energy licensing regime with respect to the clarity and certainty of reporting requirements, we recommend that IPART, in its role as licence regulator, prepare a Reporting Manual, which sets out standardised compliance reporting requirements for licensees.

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[62] Under Division 3, Clause 87B of the Electricity Supply Act, IPART has the power to request information for the purposes of monitoring compliance with the ETEF scheme.

We note that the Reporting Guidelines prepared by IPART and issued by the Minister issued for electricity licensees do set out a standardised reporting framework. These guidelines therefore form a useful basis for the preparation of a Reporting Manual. Our recommendation is for this reporting framework to be further developed in the light of the compliance monitoring recommendations in section 5.2.3. In particular, the Reporting Manual should make clear which form of compliance reporting (in terms of frequency and coverage) applies to which licence condition. The Reporting Manual should also contain all relevant information in relation to reporting, including any requirements for independent appraisal and the conduct of such appraisals (see section 5.2.4.3 below). That is, rather than having a separate document covering guidelines for independent appraisal, as currently, there would be advantages in terms of transparency in bringing these within the overall umbrella of the Reporting Manual.

In relation to gas licence compliance monitoring, a similar standardised Reporting Manual needs to be developed from scratch.

In both the gas and electricity sectors, any such Reporting Manuals should be a ‘living documents’, and should clearly indicate the version number and the date of last revision.

In order to provide certainty over reporting requirements, it is important to set out clearly the process by which the Reporting Manual will be updated. Such a process should involve adequate consultation with affected parties. In addition, any changes should apply to reporting *after* the changes have been introduced, preferably with sufficient notice given so that licensees can adapt their systems to the new reporting requirements. The more details which are provided on the process to be followed in revising the Reporting Manual (eg, time allowed for consultation; minimum notice period before changes are implemented), then the more credible the commitment to following due process will be.

From an administrative perspective, it would not seem practical for the Minsiter to approve all changes to the Reporting Manual. Rather, it would appear more appropriate for the Minister to issue an overall Reporting Guideline which requires licensees to report in line with the Reporting Manual and to approve the initial version of the Reporting Manual. The Minister’s Reporting Guideline would then nominate IPART as the body responsible for revising the Reporting Manual going forward, but would also specify the procedures IPART was required to follow in making any changes to the Reporting Manual.

5.2.4.2. Licence plans

Our recommendation is that the licence condition requiring electricity licensees to submit licence plans be withdrawn. This requirement does not lead to the furthering of policy objectives, since compliance can be achieved through the submission of a plan, rather than meeting a required output. Moreover, the introduction of more prescriptive regulatory obligations in relation to customer protection, through revised regulations, has effectively over-ridden the rationale for licensees to plan and set their own standards, and report against these. The preparation of licence plans is also onerous in terms of the reporting burden placed on licensees.

5.2.4.3. Audit requirements and CEO certification

IPART needs to have a high degree of assurance that the licence compliance data reported to it is a true reflection of licensees' performance and internal processes. Such assurance can be obtained by requiring the compliance report submitted to be subject to an external audit. In addition, or as an alternative, licensees may be required to provide certification by someone with sufficient authority within the licensed company that the reports submitted are a 'true and accurate reflection of performance.'

The current Ministerial Guidelines require electricity distribution and retail licensees to have an appraisal of the integrity of their licence compliance reports undertaken, 'by independent persons qualified to make it'.[63] Integrity means that the report is complete, and that IPART can rely on the data presented in assessing the extent of compliance by the licence holder against its licence obligations. As part of the Guidelines for Electricity Licence Compliance Annual Reporting, licensees are required to have an Independent Appraiser grade the reliability/integrity of their responses to *each* question in the electricity compliance report. Further guidelines have been issued for the conduct of such appraisals.[64] However, such independent appraisal stops should of being an independent audit, and currently the quality and coverage of the appraisals varies significantly.

It is clear that there is an important role for independent audit or appraisal as part of the compliance monitoring framework. Such independent assessment allows the body assessing licence compliance (in this case IPART) to draw on specialist skills in assessing whether licensees have reliable compliance reporting systems in place, rather than having to have those skills 'in-house'. Independent assessment provides assurance that the data reported by licensees can be used as an adequate basis to assess compliance.

The recommendations for the monitoring framework set out in Section 5.2.3 above, includes a recommendation that some licence conditions be monitored by reference to an *ex ante* assessment that adequate compliance systems are in place. The independent audit of the adequacy of compliance systems would enhance the credibility of such an approach.

However, it needs to be recognised that there are costs associated with obtaining external audits. Our recommendation is therefore that the benefit of an external audit be judged against the additional compliance costs imposed, and consideration be given to requiring an external audit for only specified clauses (specifically, those 'Type 1' conditions for which *ex ante* compliance assessment is required, and selected 'Type 2' conditions), or when there are specific doubts about the integrity of a licensee's compliance report.

63 Guidelines and Requirements Policy, clause 5.4.2(b).

An alternative to requiring an external audit would be to require the compliance reports submitted to be signed as a 'true and accurate reflection of performance' by someone with sufficient authority within the licensed company. This is the approach which has been adopted by the SAIIR.

IPART currently requires certification at CEO level and authorisation at Board level in relation to the electricity compliance reports. From a procedural point of view, we understand that obtaining CEO certification and Board approval increases the time taken for the submission of the compliance reports. However, such certification and authorisation ensures that management responsibility is imposed at a clear, discernible, and high level. It is also consistent with current approaches to corporate compliance and governance. For example, the Australian Standard on Compliance Programs (AS 3806) sets out the essential elements for establishing, implementing and managing an effective compliance program. One of these elements is organisational commitment, and requires an organisation to have a commitment to effective compliance by people at all levels within the organisation, starting with the Board or governing body, CEO and senior management.

There is also, in addition, a direct legal implication of having placed these obligations specifically on the CEO and the Board. Company officers and directors owe duties to the company, including that they exercise due care and skill. If they fail in these duties they may be personally liable for pecuniary penalties (civil fines) or damages. These duties exist both in common law and under the Corporations Act 2001.

Our recommendation is therefore that external audits be required for all *ex ante* compliance assessments (ie, Type 1 conditions) and for reporting against specified key obligations *ex post* (ie, some, but not all, Type 2 conditions). CEO certification and Board authorisation should continue to be required for remaining licence obligations. In addition, IPART should be able to require an external audit of compliance data if it has good reason to believe that the data may be inaccurate.

5.2.5. Enforcement

One of the current shortcomings of the NSW licensing regime is a lack of credibility, due to a lack of active enforcement of breaches to date.

The most effective means of demonstrating credibility is to impose penalties for licence breaches. However, this requires breaches actually to occur, and so arguably is a costly way to establish credibility (the cost being the cost associated with licence breaches). It also requires the imposition of penalties to be publicised in some way.

In order to enhance the credibility of the enforcement regime, the Minister may want to consider setting out a broad enforcement policy, along the lines of that published by Ofgem

[64] Guidelines for Independent Appraisal.

(and discussed in section 3.2.5.1). Such a policy would also assist in clarifying the route by which penalties will be imposed for breaches of the Marketing Code of Conduct, ETEF obligations and Market Operation Rules. As discussed in section 4.1.5, penalties for breaches of these obligations can currently be imposed by the Minister under the Act or as a consequence of a licence breach, or by IPART as a consequence of a licence breach. A clear policy would clarify the agency expected to be responsible for imposing a penalty for a breach of these obligations, and would demonstrate that enforcement options have been actively considered and will be imposed. In framing such a policy, however, it is important not to unduly restrict the current discretion on the Minister to determine the appropriate enforcement route and amount.

Publication of IPART's compliance report to the Minister could be a further way of enhancing the credibility of the enforcement regime. In particular, it would be one way of publicising when enforcement of breaches has occurred. However, since IPART's compliance reports are currently only submitted annually, this route would not be the most effective way of publicising enforcement action. We note that the Minister has previously published compliance reports with respect to the electricity licensees (both IPART's and the reports by the previous Licence Compliance Advisory Board). Whilst recognising that there is a danger that such reports become taken as 'performance indicators' for the government, some form of public compliance reporting would be likely to have benefits in terms of reinforcing the credibility of the compliance regime.

5.2.6. Monitoring Compliance with the Marketing Code of Conduct

The monitoring of compliance with the Marketing Code of Conduct raises a number of specific issues. As a result, we consider it separately in this section.

Experience of the introduction of full retail competition in other jurisdictions has highlighted the importance of protecting consumers from aggressive marketing practices. In the UK, licence conditions covering the behaviour of marketers were introduced in both gas and electricity retail licences in response to incidences of aggressive doorstep selling.

The Electricity Supply Act and the Gas Supply Act both allow the Minister to approve a Marketing Code of Conduct. A Marketing Code of Conduct has been prepared by the NSW Treasury, on behalf of the Ministry of Energy, and took effect from 1 January 2001. The Acts also specify the maximum penalty for breaching any such Code of Conduct, as 200 penalty units ($22,000) in the case of a corporation and 50 penalty units ($5,500) in any other case. The Marketing Code of Conduct itself sets out reporting and auditing requirements for marketers. It also nominates the Minister for Energy as the Code Administrator.

As such, the monitoring and enforcement of the Marketing Code of Conduct has been established as a 'stand-alone' regime. Given that marketers may be people other than electricity and gas retail licensees, the obligation to comply with the Marketing Code of Conduct applies to a wider group of people than those defined by the electricity and gas retail licences. In line with Section 2.2.1, such an obligation is therefore most appropriately administered via a stand-alone regime, rather than also as a licence condition.

Notwithstanding the above, the Acts also make compliance with the Marketing Code of Conduct a condition of electricity and gas retailers' licences. They also require that, as a licence condition, where a customer is introduced to an electricity or gas retailer by a marketer, that the retailer must be satisfied that the marketer has complied with the Marketing Code of Conduct and that the marketer must provide the retailer with a statement to that effect. By virtue of this condition, retail licensees are in effect acting as compliance enforcers for non-licensed marketers.

As a result, there is potential duplication between IPART's licence monitoring and enforcement role and the Minister for Energy's role as Code Administrator in enforcing the Marketing Code of Conduct.

In addition, we note that a breach of the Marketing Code of Conduct may also constitute a breach of the Fair Trading Act or, more particularly, the Door-to-Door Sales Act 1967. As such, it may also come under the potential responsibility of the NSW Department of Fair Trading.

In addressing this potential duplication, it is important to move as close to the 'ideal model' as possible, in order to maximise effectiveness. In particular, the ideal model has a single agency identified as having responsibility for monitoring compliance. This suggests two options for improving the effectiveness of the current arrangements: either dealing with compliance monitoring totally outside of the licensing framework, or bringing responsibility totally within the licence monitoring framework.

The first possibility would be to have compliance with the Marketing Code of Conduct administered separately from the licensing framework. To actually remove compliance with the Marketing Code of Conduct as a licence condition would require a change to the primary legislation. A more pragmatic approach would be the signing of a protocol between IPART and the Minister acknowledging that compliance with the Marketing Code of Conduct would not be monitored as part of IPART's role as licence compliance administrator. This approach would require the establishment of a separate compliance monitoring function under the Minister.

The second alternative would be to bring the assessment of compliance with the Marketing Code of Conduct under the same umbrella as the monitoring and assessment of compliance with other license conditions. For this to occur, IPART and the Minister would again need to agree a protocol, but this time one under which IPART was identified as having responsibility for monitoring both breaches of the Marketing Code of Conduct by licensees and also breaches by non-licensees. Under this option, IPART's monitoring and reporting with respect to compliance with the Marketing Code of Conduct would need to reflect the reporting requirements in the Code of Conduct itself.

5.3. Regulatory Roles and Functions of Each Agency

We discussed in section 3.2.6 the importance of clearly defining the roles and therefore the *responsibility* of all the institutions involved in monitoring compliance with licence obligations. This clear definition avoids omissions (ie, non-compliance with obligations not being detected and/or acted upon because it falls 'through the cracks' between agencies) and duplication of roles between agencies. As a result, the effectiveness of the overall monitoring regime is more effective, both in detecting and acting on breaches, and in avoiding the costs for both agencies and licensees associated with duplication.

We noted previously that the most effective way of clearly defining responsibility and avoiding duplications and omissions was to appoint a single agency with responsibility for compliance and/or enforcement. However, the necessary range of skills for monitoring compliance may not be present all in the same agency, resulting in the need to co-ordinate monitoring roles between agencies.

In NSW there are a number of persons and agencies who currently have responsibility for monitoring and/or enforcing licence obligations, namely the Minister for Energy, IPART, the Ministry of Energy and Utilities (through its role in approving and monitoring performance against licensees' Safety and Operating Plans), the Director of the Market Implementation Group (through the delegation of the Minister's responsibilities in relation the Market Operation Rules) and the Environmental Protection Agency (through its role in auditing licensees' environmental strategies).

In addition, there are other agencies which have a role in relation to monitoring and enforcing obligations which are also licence obligations (such as compliance with the Marketing Code of Conduct), namely EWON, the Department of Fair Trading, NEMMCO , GRMCo and the ACCC.

Our recommendation is that the role of each of these agencies as far as it relates to monitoring and enforcing compliance with licence obligations is clarified and that procedures are put in place to co-ordinate activities between agencies. Where possible, responsibilities should be centralised under one agency.

Our recommendations for streamlining the roles and responsibilities of the agencies currently involved in monitoring licence compliance are as follows:

i. IPART should retain its current overall responsibility for monitoring licence compliance and reporting to the Minister on licence compliance.

ii. The Ministry of Energy and Utilities should maintain its current responsibility with respect to approving and monitoring the effectiveness of the Safety and Operating Plans prepared by licensees and other technical reports (eg, the Network Management Report).

iii. IPART should assess compliance with licence conditions relating to safety and technical performance on the basis of whether licensees have had their Safety and Operating Plans approved by the Ministry and whether the Ministry is satisfied with the licensees' performance in relation to those plans (see Section 5.4.6). No additional reporting requirements should be imposed by IPART on licensees.

iv. Responsibility for monitoring compliance with customer protection obligations under regulations and the Market Operation Rules should be centralised under IPART, as part of its licence compliance monitoring function provided that IPART's approach to compliance monitoring is altered in line with the recommendations set out in Section 5.2.3.

v. EWON should advise both the Minister and IPART of the emergence of any systemic customer complaints, or information which may imply a breach of a licence condition.

vi. The Department of Fair Trading should also advice IPART in relation to complaints received in relation to electricity or gas retailers.

vii. Monitoring of compliance with the Marketing Code of Conduct should *either* be the responsibility of the Minister (as the Code Administrator) *or* the responsibility of IPART (under the licensing framework), but not both;

viii. If IPART's compliance monitoring role is not changed in line with the recommendations in Section 5.2.3, then monitoring of compliance with customer protection obligations under regulations, Market Operation Rules and the Marketing Code of Conduct should be conducted outside of the licence compliance regime.

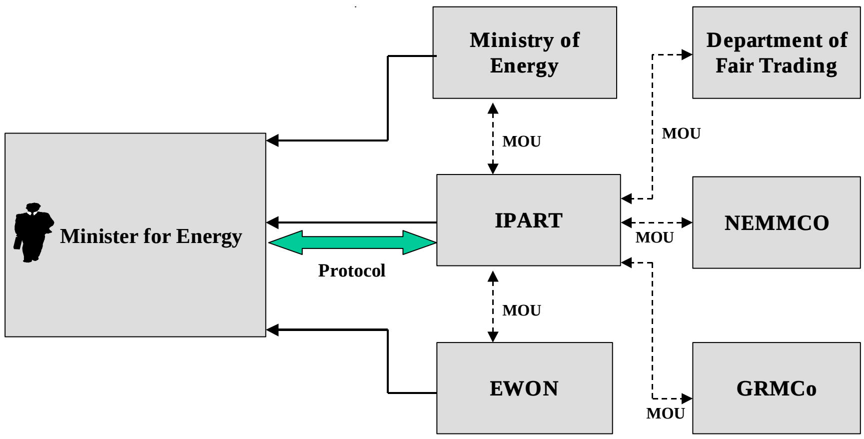
We recommend that the co-ordination described in points (i) to (viii) above be achieved through a number of Memoranda of Understanding (MOUs) and Protocols. In particular our recommendation is that the following MOUs are signed:

- between IPART and the Ministry of Energy (see description in Section 5.3.1);
- between IPART and EWON (see description in Section 5.3.2); and
- between IPART and the Department of Fair Trading, to ensure that complaints received by the Department of Fair Trading in relation to electricity and gas retailers are brought to IPART's notice;
- between IPART and NEMMCO, to ensure that information on electricity licensees registration with NEMMCO is available to IPART; and
- between IPART and GRMCo, to ensure that information on gas supplier authorisation holder's membership of GRMCo's market scheme and compliance with the scheme is available to IPART.

In addition, a protocol would need to be put in place between the Minister and IPART, clearly stating that responsibility for monitoring compliance with the Marketing Code of Conduct lies either with the Minister or with IPART (see discussion in Section 5.2.6).

The possible coverage of the MOUs between IPART and the Ministry of Energy and Utilities, and between IPART and EWON is discussed further below.

Figure 5.1: The Role of Different Agencies



5.3.1. IPART and the Ministry of Energy

As discussed in section 3.2.6, there are precedents from other jurisdictions for a division of responsibilities between monitoring safety and technical aspects of licensee's performance, and monitoring compliance with other licence conditions.

The MOU between IPART and the Ministry of Energy and Utilities should ensure that reporting and monitoring functions between the two agencies are coordinated. As such, potential coverage of the MOU could include:

- establishing a coordinated approach in finalizing the scope and timing of licensees' reporting obligations to both the Ministry and to IPART, in order to minimise reporting overlap and the consequent compliance burden on licensees;
- cooperatively addressing any perceived weaknesses in respect to safety and technical performance which may require the introduction of additional licence obligations (such as minimum standards for network performance); and
- an agreement to meet at quarterly, or as deemed necessary.

5.3.2. IPART and EWON

There are a number of precedents for coordination between consumer ombudsmen and agencies monitoring licence compliance. As a minimum, the MOU between IPART and EWON could be expected to cover:

- identifying contact points within the two organisations to be responsible for the exchange of information;
- establishing efficient working procedures for notifying IPART of systemic customer complaints and any potential breaches of licence conditions (and the Marketing Code of Conduct, if IPART is the agency responsible for monitoring compliance with the Code); and
- a commitment to hold regular formal joint meetings to discuss the nature and types of complaints being received and the emergence of any systemic complaints. With the introduction of full retail competition is may be appropriate for such meetings to be monthly. Once competition has been in place for six months, provided that no significant problems has emerged, quarterly meetings may be sufficient;

The MOU should be reviewed at least every two years, to ensure that it remains a living document and adequately addresses developments in the market.

5.4. The Substantive Content of Licence Obligations

5.4.1. Replacement of the licence obligation to submit licence plans

In order for compliance with the licensing regime to further government policy objectives, it is important that licence conditions themselves impose meaningful obligations which are linked to those policy objectives. We noted in Section 4 that one of the key shortcomings of the current NSW licensing regime is the fact that some licence conditions do not place meaningful obligations on licensees. In particular, licence conditions currently require electricity DNSPs and electricity retailers to submit 'licence plans' to the Minister. Compliance with the licence condition can be achieved simply through the submission of a plan, rather than through the achievement of a mandated objective or the undertaking of a certain action which is linked to furthering government policy objectives.

As noted in section 5.2.4.2, our recommendation is that the obligation on electricity sector licensees to submit licence plans be dropped. The requirement for licensees to submit a licence plan is a licence condition imposed by the Minister. As such, it is open to the Minister to revise this licence condition, in consultation with the Minister for the Environment.

The requirement to submit a licence plan should be replaced by licence conditions which directly cover the areas currently covered by the licence plans. The Electricity (General) Regulation already places direct customer protection obligations on licensees, in areas that would previously have been covered by a licence plan. The two remaining areas in which obligations should be introduced are (i) compliant handling and (iii) key performance indicators. We deal with these obligations below, in section 5.4.2 and 5.4.5, respectively.

5.4.2. Complaint handling

Currently electricity licensees are required as part of their licence plans to 'develop and implement plans for the responsive management of enquiries and complaints', and to include in their compliance reports a statement as to whether they adhere to 'relevant Australian Standards [ie, AS 4269] for enquiries and complaints management and to the applicable benchmarks developed by the Federal Bureau of Consumer Affairs'.

Rather than imposing an obligation to develop and implement a plan, it would be more meaningful for a licence obligation to require the licensee to have a complaint management system which meets an approved external standard, such as AS 4269.

Given that all energy sector licensees potentially deal with small customers, it would be appropriate for all licences, in both the electricity and gas sectors, to have the same licence obligation with respect to complaint handling.

5.4.3. Prudential requirements

The electricity distribution and retail licences currently contain a condition that licence holders are required to hold relevant National Electricity Market authorisations and to meet the same technical and prudential criteria that they are required to meet as a condition of such authorisations.

The gas sector reticulators' authorisation and the LPG distributors' licence both require that licence holders 'satisfy and continue to satisfy' technical and prudential criteria as adopted by the Minister. Currently no requirements have been specified. There are no equivalent prudential requirements in the gas suppliers' authorisation.

In considering whether prudential obligations in licences effectively further the government's policy objectives, it is necessary to consider what the policy imperative behind the condition may be.

For electricity and gas network monopoly businesses, which are subject to price regulation, the issue of financial adequacy is one which is a direct consequence of price regulation itself, and should be explicitly considered in setting regulated prices. Similarly, technical requirements on gas and electricity businesses should be covered in their safety and operating plans. It is difficult to see in what way including a prudency condition in licences furthers government objectives. Our recommendation is therefore that the Minister reviews the need to include the current licence conditions relating to financial prudency in the electricity DNSPs licence and in the gas reticulators' licence, with the aim of removing these conditions if a need is not identified.

On the retail side, including financial prudency as a licence condition for electricity retailers appears at odds with the move towards a competitive retail market.[65] In a competitive market, it is to be expected that some businesses will fail. As such, it should not be a condition of a business' licence that it should not be allowed to fail.[66] Rather, the important objective is for customers to be protected from undue disruption following the exit from the market of any retailer. That is the rationale behind the Retailer of Last Resort (ROLR) provisions introduced in both the electricity and gas sector. In many cases, the exit of retailers from the market will result in customers changing supplier as the result of commercial factors, without the need to invoke the ROLR provisions. However, the ROLR provisions provide a 'backstop' to protect customers in the event that they are 'stranded' by the collapse of a retailer. Providing that the ROLR provisions function as intended, then the inclusion of additional prudential requirements on licensees does not seem necessary.

Notwithstanding the above, the ROLR provisions are intended to apply in exceptional situations. A situation in which retailers enter and exit the market continually, requiring the ROLR provisions to be frequently invoked, is likely to disrupt consumers. Therefore, it may be appropriate to require prospective retailers to meet a financial 'hurdle' as a condition of their licence application (as discussed in section 5.2.2 above). It would not be appropriate to set this hurdle too high, so that it acts as a barrier to entry. Rather, the entry hurdle should be set at a level which provides a degree of comfort that the retailer has sufficient funds to operate in the market, and to 'screen out' entrants which are obviously financially unsound, so as to avoid the consequent disruption to consumers from the failure of such businesses.

A business' ability to meet an entry hurdle is a separate issue to the on-going monitoring of the financial position of the business. The fact that a business has met the entry hurdle does not imply that they will continue to meet the same financial target on an on-going basis. Rather, the imposition of an entry hurdle is a limited device to try to limit later disruption to consumers. However, the main protection from disruption to consumers comes from the ROLR provisions.

In the electricity sector, the trigger for the ROLR provisions is a signal from NEMMCO to the Treasury that a retailer has failed to meet a financial call request by NEMMCO. In order for this trigger to work, it is therefore necessary for all retailers to continue to be under an obligation to be registered with NEMMCO.[67] However, the rationale for this obligation is the need to have a trigger for the ROLR provisions, rather than to provide on-going monitoring of financial prudency.

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65 There is no equivalent licence condition for natural gas suppliers.

66 We also note that Corporations Law provides general obligations in relation to prudential financial conduct for all businesses, including gas and electricity retailers.

67 We understand that some retailers have questioned the need for this licence condition, since they wish to appoint agents to operate in the wholesale market on their account, rather than participate in the market directly.

In the gas sector, it is important that there is also an effective trigger for the ROLR provisions. In addition, we have recommended a financial 'hurdle' which new retail licensees are required to meet as a condition of their licence application (see section 5.2.2). We do not see a need to also include a licence condition requiring the on-going maintenance of a financial target.

Finally, it should be noted that on-going financial monitoring is a complicated and costly exercise, and one for which IPART does not currently have the suitable resources. Compliance with the 'financial prudency' conditions in the electricity sector licences is currently interpreted in relation to maintaining registration with NEMMCO. However, in the natural gas reticulator authorisation and in the LPG supplier licence, there is no similar delegation. The current situation is therefore one in which IPART is (nominally at least) required to monitor compliance with licence conditions in areas where it does not have the appropriate resources to conduct such monitoring. If these licence conditions remain (in variance to our recommendation above), it would therefore be necessary to review the resources available to IPART in order to allow it to adequately discharge its responsibility in this area.

5.4.4. Minimum standards

Electricity retail licensees are currently required under the Electricity (General) Regulation 2001 to meet certain Guaranteed Service Levels (GSLs), or to compensate customers for failure to meet these standards. The level of compensation is set out in the regulation. Compensation is not automatic, but has to be applied for by each affected customer.

As noted in section 4.2.3, the current GSLs may not result in meaningful obligations. Although licensees are required to make payments of $25 for a failure to turn up to appointments with 15 minutes, there is no corresponding requirement on them to set specific meeting times. In the UK, the equivalent GSL is expressed in relation to '*making* and keeping appointments' (emphasis added), and requires the licensee to make a morning or an afternoon appointment, or a timed appointment if requested by the customer.

At the same time, the rationale for introducing GSLs relating to customer service standards for retailers is open to question in an environment in which full retail competition is being introduced. Quality of service, as well as price, is one variable on which retailers may choose to compete. Where a customer is unhappy with a lack of timeliness in a retailer making appointments, it may choose to move to an alternative retailer. Again, in the UK Ofgem has announced that the GSLs it currently imposes on retailers will be withdrawn at the same time as the price control on retailers is withdrawn (planned for March 2002). [68]

[68] These GSLs relate to responding within 5 days to customer queries about charges and payments, and making and keeping appointments.

In addition, customer groups have focused on the desirability of introducing some form of minimum performance standard in relation to network reliability for electricity customers. The quality of electricity supply is of at least equal importance to electricity customers as the quality of customer service.

The assessment of the need for minimum standards (for both customer service and network performance) is the focus of part 3 of the current consultancy project. As such, we do not present detailed recommendations here for variations to the current minimum standards, or for the introduction of new standards.

However, at the level of principle, it is important that the size of the penalties which a licensee faces for failing to meet a 'minimum standard' are linked to the cost to the licensee of achieving that standard of performance. If this is not the case, licensees will have an incentive to pay the penalty rather than incur the costs (such as employing more call centre staff) of improving its service standards in the cases of those customers (or those parts of the network) which are outliers. Penalties should therefore at least reflect the cost of service improvements. Of equal importance, as an upper limit, penalties should not exceed the value that customers place on obtaining the improved service.

5.4.5. Key performance indicators

A criticism which has been made of the current regime is that the rationale for licence conditions relating to the reporting of key performance indicators (KPIs) is unclear. KPIs can be distinguished from minimum standards (or GSLs) by the fact that the latter have direct monetary penalties attached to them if the standard is not met, whilst the former do not.

Compliance with the licensing regime in relation to KPIs is restricted to determining whether or not the required indictors have been reported on.

The more fundamental question is therefore the rationale for the reporting of KPIs, in relation to the government's policy objectives. Being clear as to the rationale for reporting, in turn, assists any assessment of whether the KPIs which licensees are currently required to report on are the most appropriate indicators in terms of meeting the underlying objective.

There are a number of potential policy objectives behind the reporting of performance indicators, namely:

i. reporting on KPIs may be a necessary precursor to introducing a formal minimum standard obligation;

ii. reporting on KPIs may be used as general indicators of licensees' performance, and included in any assessment of the adequacy or otherwise of licensees' expenditure, as part of the price review process;

iii. comparative reports covering KPIs achieved by different licensees may be issued publicly, in order to provide an incentive for improved performance; and

iv. comparative reporting of retailers' service performance can improve information flows to customers, which may be beneficial in a full retail competition environment.

The first three of the rationales above relate to the underlying objective of customer protection. The fourth rationale is linked to improving the effective functioning of markets.

Reporting on KPIs can provide information on current service performance which it is necessary to have in order to introduce specific minimum standards. One example would be information on performance in relation to network reliability. As such, the rationale for requiring businesses to report on KPIs would relate to a perceived potential need to introduce specific minimum standards, in order to address what may currently be seen as performance levels which do not meet expected customer standards. The need to introduce specific standards is likely to stem from observations of performance made by the Ministry of Energy, EWON or IPART (in its role as price regulator). A decision to require reporting on this standard is in effect a policy decision, and should therefore be taken by the Minister, or delegated by the Minister (within clear guidelines) to another agency.

The publication of comparative reports on business performance is fraught with difficulties in ensuring that comparisons are made of like with like. Notwithstanding these difficulties, comparative reporting is a tool which is used by a number of regulators (including the ORG in Victoria, and both Ofwat and Ofgem in the UK). Again, a decision to issue comparative performance reports needs to be linked with the aims of a given agency. In NSW, IPART has, in its role of price regulator, recently issued its first Price and Service Report for the NSW electricity distribution businesses. We note that the Regulators Forum Report has published recommendations on a number of KPIs, which it envisages could form the basis of useful cross-jurisdictional comparison reports. To the extent that KPIs are used as the basis of comparative reports, it would appear to be sensible to align the NSW regime with the regime decided on by the Regulators Forum.

Finally, publishing KPIs on retailers' performance standards may be valuable in terms of providing an increased flow of information to consumers in a full retail competition environment. Arguably, the importance of performance standards for retailers is lessened in a competitive environment, since consumers have the ability to change supplier. However, in the early stages of FRC, an increase in the flow of information through the publication of performance indicators may be beneficial. However, to fulfil this function, reports on KPIs would need to be publicly issued, and would need to be released on a more frequent basis that the current annual reports. A quarterly frequency would appear to be more appropriate.

In summary, there are therefore a number of potential policy objectives in requiring licensees to report on KPIs. Moreover, these objectives are not mutually exclusive, with the implication that different KPI information may be requested for different reasons.

However, there is currently no clear policy rationale underlying the obligation to provide data on KPIs. We would therefore recommend that the Ministry of Energy and Utilities, the Market Implementation Group and IPART review from the perspective of the above objectives what KPI information should be collected and whether current KPIs are appropriate.

It is also important to recognise that the latter two objectives imply specific further action, in terms of the public release of comparative information. The publication of information is a separate exercise to administering licence compliance. It is an open question as to which agency is most appropriately placed to publish such information. In both cases, the publication of information will have the greatest impact, the more widely it is disseminated.

5.4.6. Safety and technical obligations

We noted in section 4.2.1 that there is currently duplication between the safety related obligations imposed by licence conditions and requirements under regulations.

In many instances, especially in the case of the natural gas authorisations, licence conditions repeat the obligations continued in the regulations. Such duplication appears to have arisen as a result of the licence conditions not being updated following the introduction of new regulation obligations. The current duplication introduces a potential ambiguity in monitoring licence conditions, since there is not a complete over-lap between the licence conditions and regulation obligations. For example, in the case of the LPG distributors' licence there are requirements on the licensee to 'take all reasonable steps to develop and operate an efficient and safe gas distribution network', but there is no reference to the Safety and Operating Plans LPG licensees are required to develop as a regulation condition.

Our recommendation is that the current apparent redundancy of the safety provisions included in businesses' licences should be removed, by replacing the current conditions with an obligation to submit a Safety and Operating plan in accordance with the regulations, and to operate in accordance with this Plan.

Arguably, including a licence requirement to comply with an obligation imposed under a regulation is not necessary, since the monitoring and enforcement of the regulation condition is one which is currently carried out by the Ministry, separate from IPART's licence compliance role. However, including compliance with the regulation is in line with our observation in Section 2 that obligations which are specific to the class of people defined by the licence should be included under the licence. It is also consistent with the inclusion of compliance with other regulation conditions under the licensing framework.

However, as with other obligations, it is important that any potential duplication of compliance monitoring by imposing obligations under two regimes is avoided. To this end, we recommend that the Ministry continue its current role of assessing and approving licensees Safety and Operating Plans, and in monitoring compliance with those plans, and that it agrees a co-ordinated approach with IPART to channel this information into the licence compliance regime (see section 5.3).

5.4.7. Environmental obligations

Electricity retailers are currently required to 'develop strategies for greenhouse gas abatement.' These strategies are required to be arrived at 'in negotiation with the Minister'. There is therefore scope for a licensees' strategies to not be agreed by the Minister. However, as noted in section 4.2.5, there are no penalties on licensees for not achieving any emissions targets set out in strategies. Compliance with the licence condition is therefore a question of submitting a strategy, rather than of undertaking a specific action or meeting a specific target.

Retail licensees are further required to develop 1, 3 and 5 years plans for energy efficiency and demand management strategies, and strategies for purchasing energy from sustainable sources. Again, the licence condition can be complied with by submitting a strategy rather than by undertaking specific action. In this case the plans do not have to be approved by an external party.

Similarly, gas suppliers are required to 'develop and implement strategies to promote the adoption of thermally efficient gas appliance and efficient energy-use practice'.

The licence condition requiring the development of environmental strategies is a condition imposed by the Minister on both electricity and gas licensees. However, in the case of electricity retailers, it is a condition which the Minister is <u>required</u> to impose under the Electricity Act.[69] There would therefore need to be a change to the primary legislation if these conditions were to be amended.

It would be possible for the Minister to introduce *additional* licence conditions, placing more meaningful environmental obligations on licensees. We understand that the obligations on licensees in relation to greenhouse gas emissions are currently being reviewed by the Cabinet Office, Treasury, MIG and the Ministry of Energy and Utilities, and that one possible outcome of this review may be a decision to impose binding emissions targets on electricity retail licensees, with financial penalties for failing to meet these targets. Licence obligations of this sort would be much more meaningful in terms of furthering government policy objectives.

DNSPs are required as a licence condition to consider demand management alternatives before augmenting their network. The NSW Demand Management for Electricity Distributors Code of Practice provides guidance on implementing this licence condition.[70]

69 Electricity Act Schedule 2 6(4).

70 NSW Demand Management for Electricity Distributors Code of Practice, May 2001, recognised by the Director-General of the Ministry of Energy and Utilities on 1 August 2001.

Specifically the Code of Practice sets out a process for DNSPs to inform the market by disclosing information regarding the current and future state of the electricity supply system, a process for consistently specifying the constraint in the electricity supply system, and a process for fairly and consistently evaluating proposals to overcome this constraint. The Code of Practice also specified reporting requirements.

Electricity DNSPs also face obligations under the National Electricity Code (NEC) in relation to the consideration of alternatives before augmenting their networks.[71] The NEC provisions go further than current licence conditions, in requiring DNSPs to consider demand management and embedded generation alternatives (amongst others) before undertaking any augmentation. The ACCC has also promulgated its Regulatory Test, which sets out the methodology that DNSPs are required to use in order to meet the NEC requirement to consider alternatives.

Given the NEC provisions, the rationale for also making the consideration of DSM alternatives a licence condition appears to be weakened. One option to avoid the current duplication would therefore be to remove the current licence condition.

However, we recognise that this licence condition is again one which the Minister is required to impose under the Act. In addition, concerns have been expressed about the applicability of the NEC provisions to distribution (as opposed to transmission) networks.

A more pragmatic alternative would be to minimise the impact of this duplication by aligning the reporting and assessment requirements for the licence condition, the Code of Practice and the NEC provisions. For example, in order to indicate that they have met this licence condition, electricity DNSPs could list the assessments they have carried out as a consequence of the NEC conditions, and provide the reports required under the Code of Practice.

71 National Electricity Code, Section 5.6.2.

6. SUMMARY OF RECOMMENDATIONS

Our recommendations for improvements to the NSW energy licensing regime are summarised below.

In relation to the administrative arrangements:

i. Obligations on licensees should be made more transparent through the preparation of consolidated reference documents issued in connection with each licence, which provide a comprehensive summary of all obligations on licensees, and what will be taken as demonstrating compliance with each obligation;

ii. These Consolidated Reference Documents would build on the current Ministerial Guidelines and Requirements, and should be living documents for which IPART has responsibility;

iii. As part of the process of issuing licences in both the electricity and gas sectors, potential licensees should be required to meet a financial threshold hurdle and to demonstrate *ex ante* that they have compliance processes which allow them to meet key licence obligations;

iv. Compliance monitoring processes should be developed by IPART in respect of both electricity and gas licensees;

v. Compliance monitoring should be tailored, based on the nature of the licence condition and the implications of a breach of that condition. Specifically, obligations on licensees should be classified as being of one of the following types:

- Type 1: an obligation for which *ex ante* assessment of compliance processes should be conducted;
- Type 2: an obligation for which frequent *ex post* compliance monitoring should be conducted (for example monthly or quarterly); and
- Type 3: an obligation for which annual *ex post* compliance monitoring should be conducted.

vi. Processes should also be put in place to enable ad-hoc compliance investigations to be undertaken, either by IPART *or* under a direction by the Minister for Energy (but not both).

vii. Reporting requirements for both electricity and gas licensees should be standardised through the establishing of a Reporting Manual, prepared by IPART in accordance with a Reporting Guideline issued by the Minister.

viii. The Reporting Manual should be of the nature of a reporting pro-forma, and should also specify auditing requirements;

ix. The Minister's Reporting Guideline should specify the process by which future changes to the Reporting Manual will be made. This process should involve consultation with licensees and any changes should be made in advance of the reporting period to which they are to apply;

x. Electricity sector licensees should no longer be required to submit licence plans;

xi. External audits should be required for reported information in relation to all licence conditions for which e*x ante* compliance assessment is required (ie 'Type 1' conditions) and for reporting against specified 'Type 2' obligations;

xii. CEO certification and Board authorisation should continue to be required for reporting relating to all remaining licence obligations;

xiii. The Minister should consider setting out a clear enforcement policy as a means of enhancing the credibility of the enforcement regime;

xiv. The monitoring of compliance with the Marketing Code of Conduct should be made the responsibility of *one* agency: either the Minister for Energy (in his role as Code Administrator) or IPART (as part of the monitoring of licence compliance).

In relation to the roles of different institutions:

i. The roles and therefore the *responsibility* of all the institutions involved in monitoring compliance with licence obligations should be clearly defined, in order to avoid omissions and duplication of roles between agencies;

ii. The roles of different agencies should be co-ordinated through the adoption of Memoranda of Understanding (MOUs) or Protocols, as appropriate;

iii. IPART should retain its current overall responsibility for monitoring licence compliance and reporting to the Minister on licence compliance;

iv. The Ministry of Energy and Utilities should continue to be responsible for assessing licensees' Safety and Operating Plans and any aspects of technical performance governed by minimum standards. The Ministry should also continue its current monitoring role for compliance with safety and technical requirements.

v. Licence compliance assessment by IPART in relation to safety and technical obligations should relate only to submission and adequacy of Safety and Operating Plans, and the meeting (or failure to meet) of technical standards, as notified to IPART by the Ministry of Energy and Utilities;

vii. IPART and EWON should establish working procedures for notifying IPART of systemic customer complaints and any potential breaches of licence conditions (and the Marketing Code of Conduct, in the event that IPART is the agency appointed to monitor breaches with the Marketing Code of Conduct).

In relation to the substantive content of licence obligations:

i. Licensees should be required to have a complaint management system which meets an approved external standard, such as AS 4269.

ii. The need for the inclusion of prudential conditions in licences should be reviewed, in the light of price regulation for monopoly distribution licensees and ROLR provisions for retail licensees.

iii. If prudential conditions are retained, the policy objective of retaining these conditions should be made clear. If IPART is the agency required to monitor compliance with these requirements, then IPART needs to develop a suitable monitoring capability.

iv. Minimum standards should be meaningful and should relate to aspects of licensees' performance which are of value to customers. The role of minimum standards will be considered further in part 3 of the consultancy project;

v. The policy objective(s) behind the requirement on licensees to submit key performance indicators should be made clear. Several possible objectives are suggested in this report. The performance indictors themselves should then be reviewed, to assess their appropriateness in the light of the policy objective(s);

vi. Consideration should be given to removing the current duplication and apparent redundancy of safety provisions included in businesses' licences, by replacing the current licence conditions with an obligation to submit a Safety and Operating Plan (in line with obligations which already exist under regulations) and to operate in accordance with this Plan;

vii. Reporting requirements for electricity distribution licensees in relation to their licence obligation to consider DSM as an alternative to network augmentation should be aligned with the National Electricity Code provisions which apply to network augmentation (and duplicate current licence requirements).

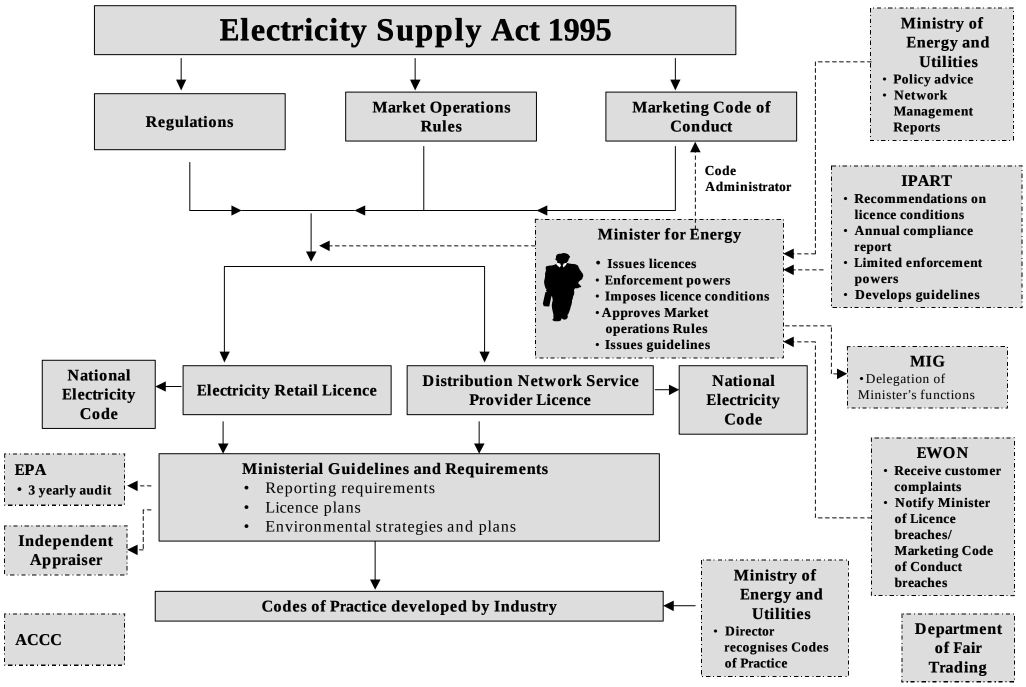
APPENDIX A. EXISTING ENERGY LICENSING FRAMEWORK IN NSW

This Appendix provides a brief background on the current energy licensing framework in NSW. Shortcomings with the current arrangements are discussed in the section 4 of the main report.

A.1. Electricity Sector

Figure 3.1 sets out the relationship between the various legal and regulatory instruments which form the basis of the licensing regime in the NSW electricity sector, and also shows the responsibility of the key agencies which play a role in administering the regime.

Figure A.1: NSW Electricity Sector Licensing Regime: Legislative and Institutional Background



A.1.1. Legislation

A key feature of the current licensing regime for electricity businesses is the extent to which obligations are spread out over a wide-range of legislative instruments.

The **Electricity Supply Act 1995** establishes the scope and structure of industry specific regulation applying in the NSW electricity sector. Specifically, the Electricity Supply Act allows for:

- Licences: specifically the Electricity Retail Licence and the Distribution Network Service Provider Licence;
- Regulations;
- Market Operations Rules; and
- A Marketing Code of Conduct.

Both the Electricity Supply Act itself and the regulations issued pursuant to the Act prescribe specific licence conditions. In addition to the licence conditions imposed by the Act and by regulations, the Act allows the Minister to impose other licence conditions, provided that they are not in conflict with those in the Act and in the regulations.

The Electricity Supply Act requires licences be subject to conditions imposed by the Act and by any regulations.[72] It further requires that each retailers' licence contain a clause requiring the holder of the licence to develop strategies to reduce greenhouse gas emissions, and that each distribution network service providers' licence contain a condition requiring the licensee to investigate demand management alternatives before expanding its distribution system.[73] The Electricity Supply Act also requires it to be a condition of the retailers' and Distribution Network Service Providers' licences that they comply with any **Market Operation Rules** approved by the Minister and the **Marketing Code of Conduct**.[74] The only Market Operation Rule to have been introduced to date applies to customer transfer in the electricity sector. The Rule has been introduced to increase protection to consumers against being transferred from one retailer to another without their consent. This is a practice (known as 'slamming') which has occurred in other jurisdictions following the introduction of full retail competition.

The Electricity Supply (General) Regulation 1996 was only very recently repealed and re-issued, to reflect the introduction of full retail competition. The new **Electricity Supply (General) Regulation 2001** contains a number of clauses relating to the treatment of electricity customers. Compliance with these clauses is required under the regulation to be a condition of businesses' licences. The regulation also sets out minimum standards of service (Guaranteed Service Levels) to be provided to customers by the licence holder.[75] In addition, electricity sector licensees are also subject to obligations under the Electricity Supply (Safety Plans) Regulation 1997.

Both the **Electricity Retail Licence** and the **Distribution Network Service Provider (DNSP) Licence** documents are currently fairly brief. They comprise a repeat of the obligations which are currently placed on the businesses as a direct result of the Act and of the

[72] Electricity Supply Act 1995, Schedule 2, 1(a).

[73] Electricity Supply Act 1995, Schedule 2, 6 (4) and 6(5).

[74] Electricity Supply Act 1995, Part 5A, 63D and Part 5B, 63I.

[75] Schedule 1, clause 5. The GSLs in the latest regulation remain unchanged from those in the 1996 regulation.

regulations, as well as detailing the licence conditions which have been imposed by the Minister.

The bulk of the detailed compliance and reporting requirements are contained in ‘guidelines established by the Minister’, which are referenced in a number of the licence clauses. A number of **Guidelines and Requirements** have been issued by the Minister.[76] IPART has been given responsibility as part of its licence audit role for the further development of these guidelines, although the approval and publication of such guidelines remains the responsibility of the Minister.

The licensing framework also reflects the fact that the electricity sector in NSW is part of the wider National Electricity Market (NEM), with licence requirements on electricity businesses to hold the right to participate in the NEM and to meet the prudential and technical requirements established by NEMMCO.

A.1.2. Institutions

As well as being characterised by a large number of legislative instruments, the NSW electricity licensing regime also involves a number of institutions, namely the Ministry of Energy and Utilities, IPART, the Energy and Water Ombudsman of NSW (EWON) and the NSW Environmental Protection Agency.

The **Minister for Energy** is responsible for issuing licences, on the advice of IPART. He also has the power to alter licence conditions, or introduce new conditions, providing that they are not inconsistent with the conditions required under the Act and under any regulations, and that he has consulted with the Minister for the Environment.[77] The Minister has the power to enforce licence compliance, through imposing sanctions or requiring remedial action (to the value of $100,000), or (ultimately) through cancelling a licence.[78] The Minister also has the power to approve Market Operations Rules. The **Director of the Market Implementation Group** in the Treasury has been nominated as a ‘prescribed person’ to whom the Minister may delegate his functions under the Electricity Act.[79] We understand that no functions have been delegated to date.

IPART has been given the central role in licence compliance monitoring, in its role as licence regulator.[80] IPART is responsible for providing recommendations to the Minister in relation

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[76] The current Guidelines applying to electricity sector licensees are: (i) Guidelines and Requirements Policy (June 2001); (ii) Further Environmental Guidelines and Requirements; (iii) Guidelines for Electricity Licence Compliance Annual Reporting 2000/01; and (iv) Guidelines for Independent Appraisal.

[77] Electricity Supply Act 1995, Schedule 2, clause 6 (9). The Minister for the Environment is the Minister currently responsible for administering the Protection of the Environment Administration Act.

[78] Electricity Supply Act 1995, Schedule 2, clause 8.

[79] The delegation has been made under Clause 117 of the Electricity Supply (General) Regulation 2001, in accordance with the Minister’s ability to delegate his functions under Section 100 of the Electricity Supply Act.

[80] Electricity Supply Act 1995, Division 1, clause 77 and Division 3, clause 87; IPART Act 1992 section 24F.

to the issuing of licences, and changes to licence conditions. IPART is also responsible for licence auditing, which entails monitoring and reporting to the Minister on the extent of licence compliance. IPART is required to prepare and forward to the Minister a report on licence compliance for electricity sector licensees in the previous financial year, annually by 31 October.[81] IPART itself has the power to levy financial sanctions or require remedial action for licence breaches up to the value of $10,000 on day 1 and $1,000 a day thereafter.[82] In addition, IPART also has responsibility for the further development of the Ministerial Guidelines and Requirements, including those in relation to compliance reporting, although the Minister retains responsibility for approving and issuing such guidelines.

The **Ministry of Energy and Utilities** ('Ministry of Energy') is the key policy making body in relation to the energy sector in NSW. Ministry staff advise the Minister in relation to policy development. The Ministry also has responsibility for the approval of the Safety and Operating Plans submitted by electricity network operators in accordance with the Electricity Supply (Safety Plans) Regulation 1997, and for the ongoing monitoring of the effectiveness of these safety plans. In addition, whilst the responsibility for monitoring licence compliance has been passed to IPART, the Ministry of Energy and Utilities monitors of electricity distribution network service providers' performance in relation to network management.[83] In particular, electricity distributors submit annual Network Management Reports to the Director of the Ministry.[84] The Ministry reports to the Minister annually in its 'NSW Electricity Network Management Report', covering issues such as the quality of electricity supply and network reliability. The Minister issues this report publicly.

It is a condition of both retailer and DNSP licences that the licence holder must be a member of an approved electricity ombudsman scheme if it supplies small retail customers and that the licence holder is bound by, and must comply with, any decision of the ombudsman.[85] The **Energy and Water Ombudsman NSW (EWON)** is currently the only approved electricity ombudsman scheme for the purposes of the NSW licensing regime. EWON has the power, under the Electricity Supply Act, to decide on complaints brought to it by small retail customers (and other persons, as set out in the regulations[86]) in relation to customer connection and supply contracts and other areas as prescribed by the regulations. The

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81 Electricity Supply Act, Division clause 88.

82 For a maximum of 30 days.

83 The submission of information on network performance by the Network Service Providers to the Ministry is currently a voluntary arrangement, although the Ministry plans to formalise this obligation via a regulation.

84 The Network Management Reports have evolved from the Safety and Operating Plan which network operators are required to submit to the Director of the Ministry of Energy under the Electricity Supply (Safety Plans) Regulation 1997. The Ministry is currently drafting a new regulation which would formalise the basis for the submission of the Network Management Report.

85 Required under the Electricity Supply Act 1995, clause 96C.

86 The Electricity Supply (General) Regulation 2001 expands on the coverage of referrals to the electricity industry ombudsman.

ombudsman is required to inform the Minister of any substantial breaches of the licence conditions or the Marketing Code of Conduct of which it becomes aware.[87]

As a condition of their licences, electricity retailers must develop strategies and plans to reduce greenhouse gas emissions from the electricity they supply. The Electricity Act requires retailers to have the effectiveness of these strategies audited by the **NSW Environmental Protection Agency** (EPA), at least once every three years.

In addition to the above agencies, who are directly involved with the licence compliance regime, it should also be noted that breaches of certain licence conditions relating to customer protection or market behaviour may also fall under the jurisdiction of either the NSW **Department of Fair Trading** or the **Australian Competition and Consumer Commission** (the ACCC), and being concurrently breaches of Fair Trading legislation (in particular the NSW Fair Trading Act) and/or the Trade Practices Act.

A.1.3. Reporting Framework

Electricity licensees submit annual compliance reports to IPART with respect to each financial year by 31 August. The Minister has published a reporting guideline (prepared by IPART) which establishes a standard reporting format for each licensee.[88] The reporting format covers compliance with each licence condition (following a 'yes/no' format), and reporting on a number of performance indicators. Licensees are required to have their 'yes/no' responses independently assessed. Pre-existing guidelines specify the conduct of these independent assessments.[89]

A feature of the current licensing and reporting framework is that licensees are required (as a condition of their licence) to submit 'licence plans' to IPART. The required coverage of these plans is set out in the Ministerial Guidelines and Requirements.[90] For example, licensees are required to report on the extent to which they have (or have not) adopted recognised **Codes of Practice**. These Codes of Practice have been developed by the industry and are recognised by the Director of the Ministry of Energy and Utilities.

As part of their compliance reports to IPART, electricity distributors are required to submit the Network Management Report they have submitted to the Ministry of Energy.

IPART submits an annual report to the Minister by 31 October on the extent of each licensees' compliance with their licence conditions. The Minister is required to table

87 Electricity Supply Act (1995), 96(B)(2)(l).

88 Guidelines for Electricity Licence Compliance Annual Reporting 2000/01.

89 Guidelines for Independent Appraisal.

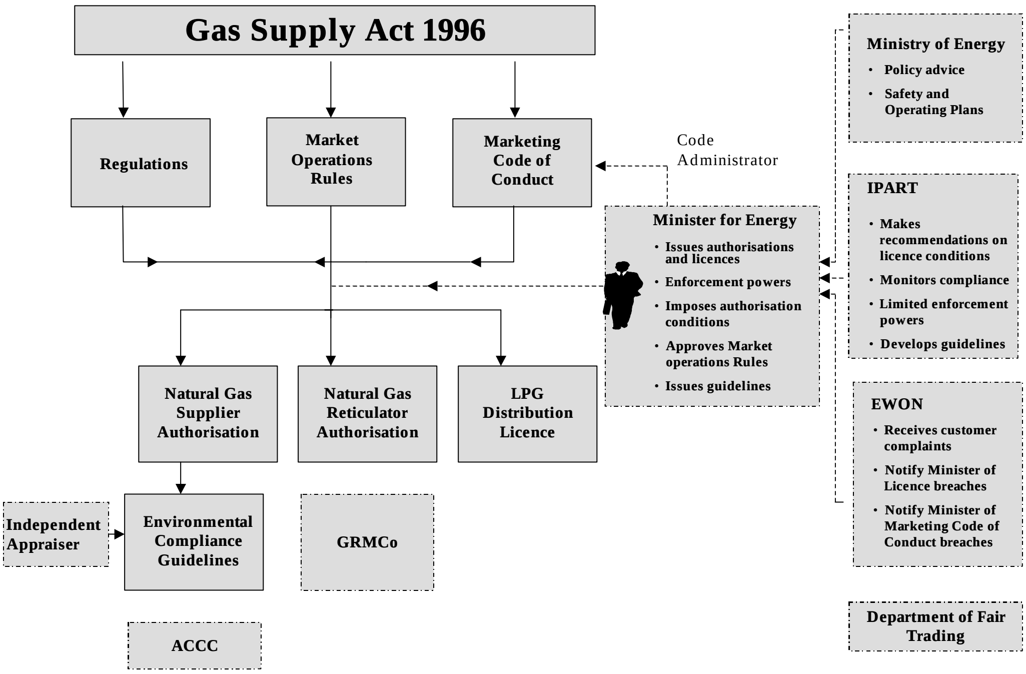
90 Licence plans are discussed in more detail in section 4.2.2.

IPART's report in Parliament, as soon as practicable after he has received it.[91] The Minister has publicly released previous compliance reports.

A.2. Gas Sector

Figure 3.2 sets out the relationship between the various legal and regulatory instruments which form the basis of the licensing regime in the NSW gas sector, and also shows the responsibility of the key institutions which play a role in administering the regime. The licensing arrangement in the gas sector covers both natural gas and LPG.

Figure A.2: NSW Gas Sector: Legislative and Institutional Background



A.2.1. Legislation

The licensing regime in the gas sector in again supported by primary legislation, namely the **Gas Supply Act 1996**.

91 Electricity Supply Act, Division 3, clause 88.

The Gas Supply Act allows for:

- Licences and Authorisations;
- Regulations;
- Market Operations Rules; and
- A Marketing Code of Conduct.

There are three **authorisations/licences** issued in relation to activities in the gas sector:

- Natural Gas Supplier Authorisation;
- Natural Gas Reticulator Authorisation; and
- LPG Distribution Licence (which covers both reticulation and retailing activities).

As in the electricity sector, gas sector authorisations/licences are subject to conditions contained in the Gas Supply Act or in regulations made under the Act.[92] Authorisations/licences may also contain additional conditions determined by the Minister, provided that these are not inconsistent with the conditions required by the Act and regulations. Unlike in the electricity sector, the Minister is not required to consult with any other Minister before varying authorisation/licence conditions or introducing new authorisation/licence conditions.

The Gas Supply Act requires it to be a condition of a Natural Gas Supplier Authorisation and a Natural Gas Retailer Authorisation that the licensees comply with the **Marketing Code of Conduct** and any **Market Operation Rules** approved by the Minister.[93] The Minister has not yet approved any market operation rules for the NSW gas sector.

There are a number of **regulations** which have been issued in the Gas Sector.[94] These regulations cover (among other things) the physical specification which natural gas is required to meet and a number of customer protection provisions. The Ministry of Energy and Utilities is currently in the process of revising the Gas Supply (Customer Protection) Regulation 1997, before the introduction of full retail competition. We understand that the new Gas Supply (Natural Gas Retail Competition) Regulation 2001 will mirror the customer protection provisions in the Electricity Supply (General) Regulation 2001.

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92 Gas Supply Act 1996: Division 1, 11(1) applies to natural gas authorisations; Part 3, 40(1) applies to LPG licences.

93 Gas Supply Act 1996, Division 4, 33L and Division 5 33P.

94 These include the Gas Supply (General) Regulation 1997; Gas Supply (Safety & Operating Plans) Regulation 1997; Gas Supply (Customer Protection) Regulation 1997; Gas Supply (General) Amendment (Natural Gas Standards) Regulation 2001; Gas Supply (Miscellaneous Amendments) Regulation 2001.

The authorisations in the gas sector are again fairly brief. Unlike the electricity sector, the authorisations do not repeat all of the authorisation obligations under the Act and the regulations. The Natural Gas Reticulator's authorisation contains a blanket condition that the authorisation "is subject to the conditions imposed by the Act and regulations".[95] All three authorisation detail the authorisation conditions imposed by the Minister. They also contain references to '**guidelines or criteria established by the Minister**' in relation to what will be taken to determine compliance with some licence conditions. To date, the only set of guidelines which has been issued relates to compliance with environmental guidelines, applicable to natural gas suppliers only.[96]

A.2.2. Institutions

The key agencies which have a role in the electricity sector licensing regime also fulfil similar responsibilities in relation to the NSW gas sector.

The **Minister for Energy** is the person empowered under the Gas Supply Act to issue licences and authorisations, on the advice of IPART. He also has the power to alter authorisation/licence conditions, or introduce new conditions, providing that they are not inconsistent with the conditions required under the Act and under any regulations. The Minister has the power to enforce authorisation/licence compliance, through imposing sanctions or requiring remedial action (to the value of $100,000), or (ultimately) through cancelling an authorisation.[97]

IPART has been given responsibility for monitoring authorisation compliance in the gas sector.[98] IPART is responsible for providing recommendations to the Minister in relation to the issuing of authorisations, and changes to authorisation/licence conditions. IPART is also responsible for monitoring and reporting to the Minister on the extent of authorisation compliance. In contrast to the electricity sector, there is no formal requirement under the Act for IPART to submit an annual compliance report to the Minister. IPART itself has the power to levy financial sanctions or require remedial action for authorisation breaches up to the value of $10,000 on day 1 and $1,000 a day thereafter.[99] It can also advise the Minister on the need for sanctions to be applied. In addition, IPART has responsibility for the further development of the Ministerial guidelines and requirements, including those in relation to compliance reporting, although the Minister retains responsibility for approving and issuing these guidelines.

95 Clause 2(a).

96 Supplier's Authorisation, Guidelines for Compliance with Environmental Conditions.

97 Gas Supply Act 1996 clause 13 (for natural gas licences) and clause 42 (for LPG licence).

98 Gas Supply Act 1996, Part 5A, 75A; IPART Act 1992 section 24F.

99 Gas Supply Act 1996, Clause 13A (for natural gas licences) and clause 42 A (for LPG licence). The $1,000 a day penalty can be applied for a maximum of 30 days.

The **Ministry of Energy and Utilities** is again the key policy making body in the gas sector. In addition, gas network operators must submit a Safety and Operating Plan to the Director of the Ministry of Energy and Utilities, in accordance with the Gas Supply (Safety and Operating Plans) Regulation 1997. Operation of the network in accordance with this Safety and Operating Plan is an authorisation condition for natural gas reticulators. The Ministry has not, to date, adopted the same technical performance monitoring role which it carries out in the electricity sector. However, we understand from discussions with Ministry staff that they are currently developing a reporting pro forma for gas network businesses which would address wider network performance issues.

The Gas Supply Act also makes provision for a gas industry ombudsman scheme, and for the role of the ombudsman in relation to reviewing complaints from small retail customers. **EWON** is currently the only approved gas industry ombudsman scheme for NSW. The Gas Supply Act makes it a condition of natural gas supplier authorisations that the licence holder must be a member of an approved electricity ombudsman scheme and that the licence holder is bound by, and must comply with, any decision of the ombudsman.[100] As in the electricity sector, the ombudsman is required to inform the Minister of any substantial breaches of the authorisation/licence conditions or the Marketing Code of Conduct of which it becomes aware.[101]

The **Gas Retail Market Company (GMRCo Ltd)** was established on 15 December 2000 by the NSW gas industry. GRMCo's role is to act as the entity responsible for managing the development and operation of the IT systems necessary to facilitate a competitive gas retail market in NSW, based on the business rules developed by the industry. It is a condition of natural gas retail suppliers' authorisations that they belong to an approved scheme to support full retail competition. The scheme operated by GRMCo is soon to be approved, and is the only such scheme set up for suppliers' to belong to.

Again, it should be noted that breaches of certain authorisation conditions relating to customer protection or market behaviour may also fall under the jurisdiction of either the **NSW Department of Fair Trading** or the **Australian Competition and Consumer Commission** (the ACCC), and being concurrently breaches of Fair Trading legislation and/or the Trade Practices Act.

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100 Required under the Gas Supply Act 1996, clause 33H. membership of EWON is not required for natural gas reticulators or LPG distributors.

101 Gas Supply Act 1996, 33G(20(l)).

A.2.3. Reporting Framework

There is currently no established pro forma for authorisation/licence compliance reporting in gas.

All gas authorisation holders/licensees currently submit annual reports to IPART covering high level financial information.[102] This report is due by 30 September each year with respect to the previous financial year.

Natural gas reticulators are required to submit an annual report quantifying unaccounted for gas and estimating gas losses for the previous financial year to the Director of the Ministry. These reports are also due by 30 September each year.

Natural gas suppliers and LPG distributors are further required to submit an annual plan covering the development and implementation of a Consumer Safety Awareness Program. These reports are due on the 'anniversary date' of the initial submissions of such a plan. These reports are currently submitted to IPART.

In addition, natural gas suppliers are required to submit an annual report on their environmental strategies, in line with guidelines issued by the Ministry. The environmental strategy reports must be verified by an independent person. In addition, the effectiveness of the strategies must be assessed by an independent person at least every three years. These reports are due on the 'anniversary date' of the initial submissions of an environmental strategy. These reports are currently submitted to IPART.

To date, neither the Ministry nor IPART have reported to the Minister on gas authorisation holder compliance. There have also been no public reports issued on compliance of gas authorisation holders with their authorisation conditions.

[102] Financial reporting requirements for natural gas suppliers are detailed in their authorisation clause 3.2.1. For natural gas retailers and LPG distributors licences conditions refer only to information on the licensee's 'financial status'. No additional guidelines have been issued.