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By email: scer@ret.gov.au

Senior Committee of Officials
Standing Council on Energy & Resources
c/o Department of Resources & Tourism
CANBERRA ACT 2601

Dear Sir/Madam

Consultation Regulation Impact Statement
Limited Merits Review of Decision-Making in the Electricity and Gas Regulatory Frameworks

We welcome the opportunity to respond to the Consultation Regulatory Impact Statement (**RIS**) on the framework for limited merits review of decision-making in electricity and gas regulation, released by the Senior Council of Officials (**SCO**) of the Standing Council on Energy and Resources (**SCER**).

Consumer Action provided four submissions to the Expert Panel established to review the framework for limited merits review, as well as a submission to the SCER ahead of its publishing the RIS. Rather than repeat the content of those submissions, we have responded to the questions listed in the RIS. We anticipate the SCO has access to and will take account of those submissions as part of this process. If that is not the case, please advise us and we will be happy to provide them.

In short, our view is that Option 3 is the most appropriate option under consideration.

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action offers free legal advice, pursues consumer litigation and provides financial counselling to vulnerable and disadvantaged consumers across Victoria. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

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General

1. Do stakeholders agree access to merits review should be maintained?

During the review, we advocated for the abolition of merits review (but for energy businesses to retain the right for judicial review) or, as second preference, for review to be only allowed where the entire decision is reviewed (a *de novo* review). While the Final Report states that its suggestion will not result in a *de novo* review because, for example, the review body would be required to adopt the primary decision as its starting point, we are supportive of its recommendation as we agree it will significantly change the risk/reward calculation for energy networks considering an appeal. In short, it appears that the approach suggested will significantly reduce the number of appeals.[1] It is only in the above circumstances that we consider access to merits review should be maintained, i.e. full implementation of the Expert Panels recommendation or a de novo review model. Absent either of those outcomes we consider that access to merits review should not be maintained.

2. Do stakeholders consider that a consistent approach to limited merits review of electricity and gas regulatory decisions remains appropriate?

We are supportive of a consistent approach to review of electricity and gas regulatory decisions, but for the avoidance of doubt we do not support a limited merits review approach in either market. We note also that we do not consider it helpful to attempt to describe the model recommended by the Expert Panel as limited merits review. This terminology is very much associated with the discredited currently existing system of review in the electricity market.

We note that RIS states that there are existing differences in merits review of gas regulatory determinations compared to electricity determinations. It notes that for electricity, each component on an entire determination is open for review, while for gas, where the regulator makes a determination on access arrangements, the reviewable decision is the overall determination.

We agree with the Expert Panel's comment that 'the ultimate focus of merits review should be on the overall price/revenue determination, rather than the assessment of specific components (or constituent parts) of that decision'.[2] This should apply equally to electricity and gas determinations.

[1] Note for the avoidance of doubt that this support is entirely contingent on the presence of both elements recommended by Expert Panel, i.e. the single ground of a "materially better decision" and a definition of materially preferable decision as proposed by the Final Report. We consider for example that moving to a single ground of appeal without changing the objective and thereby the definition of preferable decision would fail to redress the imbalances in the current system.

[2] Yarrow, Egan & Tamblyn, *Review of the Limited Merits Review Regime—Stage 2 Report,* 30 September 2012, p 57.

Option 1—Status Quo

3. Are there any minor amendments to the NEL and NGL that could address the problems identified by the Panel?
4. To what extent do recent reforms, most notably recent network regulation rule changes, address the concerns identified by the Panel?

Minor amendments to the NEL and NGL will not address the fundamental problems identified by the Panel, in particular, that the regime has operated as contest focused not on reaching a preferable decision but more on changing the distribution of economic resources between network owners and energy consumers—a contest in which consumers are at a distinct disadvantage.

We agree with the Expert Panel's conclusion that more fundamental reform is required and that the way the merits review framework has promoted appeals activity has contributed to a loss of confidence in the overall regulatory framework. That the merits review framework has produced outcomes that are not established to be in the long-term interests of consumers—but rather outcomes that are the result of technocratic processes that have benefited energy networks to the tune of more than $3 billion—is a fundamental failure of the regulatory framework that cannot be changed without reorienting the nature of the appeals system.

The RIS suggests a number of benefits of the status quo. These include the fact that it is understood by all stakeholders in the energy market. We contest this—we would argue that there is a significant lack of understanding among consumers about the appeals processes and an inability for consumers to participate in these processes. The report, *Barriers to Fair Network Prices*, explained in detail the challenges faced by consumer agencies wishing to intervene in merits review decisions.[3]

The RIS also suggests that the Australian Competition Tribunal's (the **Tribunal**) reviews to date have created a body of precedent which provide an understanding of how the regulatory regime is to operate. We do not see that these decisions cannot continue to be used by the regulator in guiding its future decision-making (where relevant). The relevance may be questioned however given the precedents in question derive from proceedings that examine individual components of a decision rather than the overall merit of the decision itself—the very approach that has been discredited by the Expert Panel report. In these circumstances we do not believe that the creation of precedent is a significant benefit and certainly not one that outweighs the significant consumer detriment that has resulted from the status quo to date.

We note that recent energy market reforms have endeavoured to bring consumers and consumer interests to the forefront of policy making. Both the rule change finalised by the Australian Energy Market Commission in November 2012[4] and the package of reforms agreed to by the Standing Council on Energy and Resources in December 2012[5] should improve consumer outcomes. The former provides more robust powers to the Australian Energy Regulator (**AER**) to

[3] Consumer Action and Consumer Utilities Advocacy Centre, *Barriers to Fair Network Prices,* August 2011, available at: http://consumeraction.org.au/policy-report-barriers-to-fair-network-prices/
[4] Australian Energy Market Commission, *Rule Determination: Economic Regulation of Network Service Providers,* November 2012.
[5] Standing Council on Energy & Resources, *Electricity: Putting Customers First*, December 2012.

interrogate, review and amend expenditure proposals put forward by network businesses, which should ensure that more reasonable determinations are made by the regulator. The latter proposes, among other things, a new national consumer advocacy body that may be better equipped to provide consumer input into regulatory processes.

While we strongly support these initiatives, we suggest that without fundamental reform to the framework for limited merits review, these reforms will not achieve their objectives. Improved powers and discretion provided to the AER will not assist consumer outcomes if the AER decisions can be easily appealed in a framework that lacks consumer focus and participation. We also believe that any new national consumer advocacy organisation would struggle with the same challenges faced by Consumer Action and the Consumer Utilities Advocacy Centre (as outlined in *Barriers to Fair Network Prices*), even if it had more resources dedicated to energy advocacy functions and technical expertise. Imbalance in information, short time frames to engage, grounds that make it legally difficult to make out the case for intervention and risks of adverse costs orders would all make intervention challenging for a consumer advocacy organisation.

Option 2—Amendments to the Framework as proposed by the Panel, but retaining the Tribunal as the review body

5. What impact would the move to a single "materially preferable decision" criterion have on the outcomes of the limited merits review regime? Specifically, to what extent would such a criterion be compatible with retaining the Tribunal as the Review Body and what limitations might apply to the Tribunal in administering such a criterion?
6. Are there any barriers to the Tribunal effectively performing its role in a purely administrative manner? What impacts would a move to a more administrative, less judicial approach have on the review process including the extent to which it would reduce or remove the need for participants to engage legal counsel?

We are broadly supportive of the Expert Panel's recommendation that there should be a single ground for appeal, that is, that there is reason to believe that there is a materially preferable decision as defined in the Final Report. As outlined above, we submit that such a criterion will change the risk/reward calculation for energy networks considering an appeal and reduce the number of appeals.

We believe, however, that in addition to the single criterion, the Expert Panel's related recommendation must be implemented—that is, that a preferable decision is one that ensures that regulatory determinations promote efficiency in investment, operation and use of networks in ways *that best serve* the long term interests of consumers. The intention here accords with our submissions to the Expert Panel that there can be many views regarding ways in which efficiency can be improved or a better decision be made, but that the key determining factor should be the decision that best serves the long term interests of consumers. We strongly support the proposal from the Expert Panel that the National Electricity Objective and the National Gas Objective be amended to include the words "in ways that best serve" before the long term interests of consumers.

While we do not think that the Tribunal would be necessarily unable to administer this single criterion, we do think that it may face challenges due to mode of operation. The Tribunal conducts itself in a quasi-judicial or court-like fashion—the Expert Panel describes it's approach as being adversarial and formal in nature.[6] Tribunals with a quasi-judicial approach are not uncommon in Australia but their decision-making can be limited to the submissions and evidence brought before them and, in the case of administrative review of economic decisions, are often required to be wielded by legal counsel and international experts. Such an approach may be contrasted with more investigatory or inquisitorial approaches to decision-making, which are commonly undertaken by regulators or ombudsmen. An investigatory approach is likely to be required so that the Tribunal is able to assure itself that it has garnered all the information necessary to make a decision based on the single criterion.

As argued by the Expert Panel, while the Tribunal may be able to adopt a more investigatory approach, this seems unlikely in the context of its other functions. The Tribunal has a number of functions across competition and economic administrative decisions, and we do not think it would be a simple to recast the work of the Tribunal in relation to energy alone. Given that the reform proposed by the Expert Panel heavily relies upon a significant change to the process for the limited merits review (that is, the way the review is undertaken), we do not support the Tribunal being the review body.

There may be some efficiencies to be gained by sharing some back office functions with the Tribunal such as administration and finance. This would require additional care that it is understood that the approach and focus of the new body is very different to that of the Tribunal.

7. What, if any, restriction should be applied to the information the Tribunal can consider after the ground for review has been established? Are there any benefits associated with allowing the Tribunal to consider information that the regulator could not have reasonably considered in its initial decision making process?

We are supportive of the review being limited by the Tribunal being only able to access the information that was before regulator at the time of its decision. We note that Option 2 as described in the RIS would limit the Tribunal this way before the ground for review has been established, but that following the establishment of the ground of review, the Tribunal could seek additional information from interested parties, subject to that information not being unreasonably withheld from the regulator at the time of the decision.

Our concern is that this may create incentives for regulated businesses to withhold information until the appeal stage—while the requirement of reasonableness offers some protection, there remains a risk that the review process will not operate as an accountability measure on the regulator (as intended), but may be used by businesses to have a 'second go' at a regulatory decision.

We think the same position should be applied to other non-business appellants or interveners, whether they are consumer groups or others. The current framework requires an appellant or intervener to have participated in the original process—this seems a sensible rule to ensure the

[6] Yarrow, Tamblyn & Egan, above n 2, p 22.

merits review process does not discourage all relevant material to be provided to the regulator in relation to the initial decision.

Option 3—Amendments to the framework as proposed by the Panel and establishing a new limited merits review body

8. Are there specific benefits and risks associated with the Panel's model for the Review Body? Do stakeholders have any views on how the model could be modified to address these risks? This might include, but not limited to, the restrictions around information or process. How might those modifications affect the effectiveness of the investigative process?
9. What level of prescription around the establishment and operation of the Review Body do stakeholders consider necessary? Specifically, how would introducing a requirement for a judicial member, whether current or retired, to the Review Body (be it as a Deputy Chair or standing member) ameliorate concerns that the Review Body would not give due consideration to the legal issues? Is there a risk that this may create a pseudo Tribunal?

We agree that there a benefits flowing from establishing a new review body, separate from the Tribunal. Building on the above, the design for a new body could ensure that it operates in an administrative and inquisitorial manner rather than an adversarial manner, thereby ensuring that the interests of consumers remain primary throughout the review process.

The RIS suggests that key risks for Option 3 include uncertainty about how the review body would operate and jeopardising the ability of network businesses to secure finance for necessary investments. It the very nature of any proper appeal process that the outcome is uncertain. Certainty is provided by the original regulatory decision—any appeal which creates uncertainty is within the discretion of each regulated business to pursue or not pursue. We therefore submit that any such risk is proper and can be mitigated.

In terms of jeopardising network businesses ability to secure finance, we believe this is a non-issue. All the market analysis suggests that investment in private network businesses is resilient as they produce stable and strong returns. There is also no suggestion that government-owned network businesses will be unable to secure finance. Commentaries suggest that some businesses were able to lock in high rates of return as regulatory assumptions were calculated during the peak of the global financial crisis, and the five year regulatory period means that they have been able harness above market margins over a number of years.[7] We think it is entirely appropriate that some of this revenue be returned to consumers. However, given these businesses' revenue is regulated, then it is likely to be stable and guaranteed over the longer term.

While we support the establishment of a separate review body, we are not supportive of the Expert Panel's recommendation that this body be placed within the Australian Energy Market Commission (**AEMC**). As we argued in submissions to the Expert Panel, there may be a conflict between this role and its role as the rule-maker, even if there is some separation of decision-making within AEMC. If sharing of resources is necessary in the establishment of a new appeals

[7] Intelligent Investor, *Spark's value rising as interest rates fall,* 7 February 2012, available at:, http://www.iifunds.com.au/category/blog-keywords/wacc

body, we would encourage consideration of entities which are likely to have expertise but not to be too ‘close’ to the subject matter at hand.

The constitution of the review body should be set by governments. We think the constitution could be broad, and involve those with expertise in regulatory economics, the energy industry, consumer interests and legal knowledge. A diverse range of experts on a 'panel' of the review body should not mean that the review body would need to act as a 'pseudo-Tribunal'. This could also be guarded against should the framework establishing the body be clear about its intended mode of operation to be administrative and investigatory, rather than court-like.

We agree with the RIS's analysis that there would be costs in establishing the review body, and that network businesses could fund these costs—costs which would flow through to consumers through network charges. Despite this, we think this cost will be relatively modest should Option 3 be implemented in full—a mere fraction of the more than $3 billionn transferred from customer to businesses under the current appeal regime is required. As described above, Option 3 should produce a lesser quantum of reviews which would mean a less overall cost. Option 3 would also mean a reduction in legal and other costs incurred from administering the existing review system. These costs reductions should easily offset any costs incurred in the establishment of the review body.

Please contact us on 03 9670 5088 or at gerard@consumeraction.org.au if you would like to discuss these matters further.

Yours sincerely
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