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4 October 2016

COAG Energy Council Secretariat
GPO Box 9839
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**APA Group submission to the COAG Energy Council Consultation Paper: Review of the Limited Merits Review Regime**

APA Group (APA) welcomes the opportunity to comment on the COAG Energy Council Consultation Paper: Review of the Limited Merits Review Regime.

The consultation paper has raised a number of complex and inter-related issues, which require careful consideration. APA appreciates the short extension to the deadline, recognising the public holiday in NSW, for lodgement of its submission on this discussion paper.

Please call me, on 02 9693 0053, if you would like any further information.

Yours faithfully

Peter Bolding

General Manager Strategy and Regulatory

3 October 2016

# Review of the Limited Merits Review Regime

## APA Group submission.



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# Contents

# 1 Summary

At the highest level, APA considers:

- There are sound legislative reasons to maintain access to Limited Merits Review;
- Removing access to Limited Merits Review would produce unintended consequences for the gas industry, relating to Coverage and Light Regulation decisions.
- A specialist expert review body should be retained;
- It is premature to make major changes to the Limited Merits Review regime;
- There may be scope to make some minor changes to the regime based on our experience to date.

## 1.1 Outline

In preparing this response APA have focused on providing both relevant material that must be considered in any review of limited merits review as well as responses to the specific questions raised by the Limited Merits Review Team in their consultation paper.

As a result of these considerations APA have structured this response in three parts;

- The need for merits review
- APA response to "Assessing the performance of the LMR Regime"
- APA response to "Potential options"

# 2 The need for merits review

## 2.1 Should the decision of the AER be subject to Merits Review?

Today, merits review is a recognised part of the best-practice development of legislative instruments. Senate Standing Order 23 requires a Senate committee to scrutinise each new instrument to ensure[1]

> *that it does not unduly make the rights and liberties of citizens dependent upon administrative decisions which are not subject to review of their merits by a judicial or other independent tribunal*

The Australian Government's Administrative Review Council (ARC), is a key advisory body on matters relating to merits review. Its 1999 publication, "What decisions should be subject to merits review?" sets out criteria for identifying a merits reviewable decision. When the regulatory decision making of the Australian Energy Regulator (AER) is assessed against these criteria (as APA has done in Appendix A to this submission), the conclusion is, resoundingly, that the regulator's decisions should be subject to merits review.

## 2.2 Unintended consequence of removing Limited Merits Review

The gas access regime has a wider range of matters that are subject to merits review than the access regime of the National Electricity Law and the National Electricity Rules. Section 244 of the National Gas Law (NGL) sets out what is subject to merits review.

> *reviewable regulatory decision means—*
>
> *(a) a Ministerial coverage decision; or*
>
> *(b) a light regulation determination or a decision of the NCC under Chapter 3 Part 2 not to make a light regulation determination; or*
>
> *(c) decision of the NCC under Chapter 3 Part 2 to revoke or not revoke a light regulation determination; or*
>
> *(d) a designated reviewable regulatory decision;[2] or*

[1] Parliament of Australia, Standing Orders and other orders of the Senate, June 2009, Standing Order 23.

*(e) an AER ring fencing determination; or*

*(f) a decision of the AER under section 146 to give an exemption; or*

*(g) an associate contract decision; or*

*(h) a decision of an original decision maker that is prescribed by the Regulations to be a reviewable regulatory decision,*

*but does not include a decision of the AER made under Chapter 10 Part 2;*[3]

The electricity equivalent to this provision is set out in s71A of the National Electricity Law.

*reviewable regulatory decision means—*

*(a) a network revenue or pricing determination that sets a regulatory period; or*

*(b) any other determination (including a distribution determination or transmission determination) or decision of the AER under the Rules that is prescribed by the Regulations to be a reviewable regulatory decision,*[4]

*but does not include a decision of the AER made under Division 6 of Part 3;*[5]

In the gas access regime, decisions relating to the applicability of regulation to gas pipelines (coverage decisions by the Minister), and decisions relating to the form of regulation to be applied to covered pipelines (light regulation decisions by the NCC), are reviewable decisions. There are no equivalent reviewable decisions in the electricity regime.

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[2] NGL s2: *designated reviewable regulatory decision* means an applicable access arrangement decision (other than a full access arrangement decision that does not approve a full access arrangement);

[3] Chapter 10 Part 2 relates to the handling of confidential information.

[4] The regulations set out decisions under the National Electricity Rules 6.6.1(d); 6.6.1(g); 6A.7.3(d); and 6A.7.3(g). These provisions relate to cost pass through decisions for electricity distribution and transmission networks.

[5] Part 3 Division 6 relates to the handling of confidential information

To date there has been a significant focus on merits review as it applies to AER economic regulatory decisions, however, it is important that policy makers consider the negative impact that changes to the merits review process could have on coverage and form of regulation decisions. In any consideration of merits review in relation to coverage and light regulation decisions, policy makers should recognise that there is a different decision making process, different considerations and a different decision maker when compared to AER regulatory decisions. These decisions are also much less frequent , and can have very significant ongoing impacts on a business.

In light of this it is noteworthy that, while the ACCC has recommended a review of the coverage test, it is not recommending that merits review of coverage or light regulation decisions be removed. Indeed, the ACCC goes further to recognise that merits review is an important safeguard against regulator error, and to advise that it was not an element of the gas access regime which it would change.[6]

It is also important to recognise that merits review has been a feature of the National Gas Access Regime since its inception in 1997.

More detail in relation to this issue is available in section 4.4.2.

## 2.3 Merits review and investment in infrastructure

As highlighted by the Financial Investors Group submission to the expert panel's review of limited merits review in 2012, Investors see the right to merits review as a fundamental protection against any misuse of the administrative powers vested in regulatory authorities that may emerge over time.

APA considers that regulatory certainty is a critical component of the regulatory regime to allow investors to attract capital in global capital markets for investment in Australian energy infrastructure. Where the regulatory regimes of overseas regulatory frameworks are more stable and certain than those of the Australian regulatory framework, investors may make a binary decision about whether to invest or not invest in Australian energy infrastructure. Regulatory uncertainty translates directly to a significant and negative impact on investor perception of the risk of investing in regulated assets, which makes it more difficult to attract capital to

[6] ACCC, *Inquiry into the east coast gas market*, April 2016, page 12.

Australian energy infrastructure assets, which ultimately increases the costs to consumers.

Due to the long term nature of infrastructure assets, investors require a high degree of certainty in relation to the return on capital they can expect to receive in order to commit capital to such assets. For the AER's decisions not to have an adverse impact on investor perceptions of investment risks, investors must be confident that the business is able to contest and correct errors in the AER's decisions (on rate of return in particular) to ensure it makes sound decisions which can stand up to scrutiny.

## 2.4 Upcoming reviews of the gas access regime

Given the important reasons for having merits review it is particularly important that merits review be retained for the near future.

One of the key purposes of merits review is to clarify the interpretation of new rules, regulations and legislation and to ensure that discretion is exercised consistent with policy intent.

At its August 2016 meeting, CoAG tasked the AEMC to undertake a review of Parts 8 through 12 of the National Gas Rules (the parts relating to economic regulation) as part of the current suite of reforms. As with any legislative change, there will be scope for uncertainty in the interpretation and application of any new Rules that may come out of that reform process.

## 2.5 It is premature to entertain major changes to the merits review framework

We have not yet had the opportunity to experience the benefits of merits review through:

- added clarity to the interpretation of the Rules;
- guidance to the decision-maker in its decision-making; or
- influencing the preparation of regulatory submissions from the regulated businesses.

Integral to these outcomes is the process of the Australian Competition Tribunal (ACT) establishing precedents for the AER and itself with each decision it makes.

Precedent would be expected to reduce the need for future merits review decisions as it would achieve the outcomes being sought; networks would

have clarity on the law and adjust their submissions accordingly; the AER would be able to rely on it to support their decision making and the body of decisions would add further clarity to the meaning of the rules.

However, to be effective, use of precedent requires a body of decisions to be available this can only be achieved over time in a stable legal environment. Many of the AER decisions submitted to review relate to new areas of regulatory rule making, such as the use of benchmarking to determine capital and operating allowances and the approach to determining a regulated rate of return. Given the role of merits review to clarify the intent of rules and the associated benefits that arise from that from the development of precedent, it is important that a stable regulatory and merits review environment is achieved.

As the first round of merits review applications under the rule change that introduced changes to economic regulation, including the approach to the rate of return and the 2012 Limited Merits Review changes have yet to be finalised it is impossible for the AER to use ACT precedents to justify its decisions nor see how businesses are adjusting their applications in the light of past decisions.

It is also unclear on what is the scope of merits review that is being considered in this review as the AER has appealed the decision of the ACT to the Federal Court on the basis of whether the grounds of review were properly established by the network businesses and whether these were correctly applied by the Tribunal. This goes to the heart of the nature of the matters that can be pursued under merits review by network businesses and consumers. The Federal Court is expected to hear the matter in October.

As the scope of the decision maker and the role of precedent are fundamental aspects of any legal system being able to deliver the intended outcomes it is difficult to justify major reforms to the limited merits review process.

## 2.6 What type of review body?

Economic regulation is a complex and technical undertaking. It requires a strong understanding of economic and legal principles and the operation of utility businesses.

These characteristics lend themselves to a specialist review body, such as the ACT, rather than a generalist review body such as the Administrative Appeals Tribunal.

The strength of a specialist review body is it can combine a legal expert (in the case of the ACT a federal court judge) with subject matter experts. A strong understanding of regulation puts the tribunal in a good position to distinguish between whether a matter is a necessary but subjective exercise of discretion or an error on the part of the primary decision maker.

An additional strength of a specialist review body is the ability for the review body to engage their own experts[7] where it would assist the Tribunal to obtain information or material in order to determine whether a materially preferable designated NGO decision exists. APA notes that the Tribunal has made use of these provisions, notably in the Energex "Gamma" case.

[7] Under s261(3b) of the NGL

# 3 Assessing the performance of the LMR regime

This section is structured on the same basis as the Limited Merits Review Project Team's (the Project Team) consultation paper. APA has responded to those questions posed by the Project Team where our role as industry participant and experience with past regulatory decisions puts us in a position to be able to provide the Project Team with insights into the operation of the LMR Regime.

## 3.1 Threshold for Review

### 3.1.1 *Question 1: Are there any specific factors which prevent issues being resolved through the determination process?*

As the purpose of merits review is to correct regulator error made in the determination process the only legitimate change to the framework that can reduce the number of merits review applications is to reduce the number of decisions the regulator is making. One way to do this is to make reforms to the way the Rate of Return Guideline is made.

The discussion paper notes that "over 50 per cent of regulatory decisions on electricity network revenue and gas access arrangements since the 2013 reforms were implemented have been subject to applications for review".[8]

APA observes that there is a considerable overlap of matters being promoted through the current suite of LMR applications, largely relating to cost of capital related issues.

APA considers that the driver of this overlap is the number of decisions made by the AER which have been the subject of the Guideline development process, particularly the AER's Rate of Return Guideline.

In particular, the repetitious merits review proceedings are driven by the fact that, while many businesses are of the view that the AER's Rate of Return Guideline contains material errors of fact and discretion, the decision to produce a Guideline is not a reviewable decision under s244 of the NGL.

[8] *Review of the Limited Merits Review Regime - Consultation Paper*, Limited Merits Review Project Team, 6 September 2016, p10.

The only scope for businesses to seek correction of the errors made in the development of the Guideline is the individual regulatory determinations in which the Guideline has been applied. Where the AER releases a "set" of decisions together (for example, the five Victorian electricity distribution determinations), each of which are affected by the errors made in the Guideline, then the outcome will be a "set" of merits review applications, each seeking to correct the same errors.

Noting that the Rate of Return Guideline is not binding on either the regulated business or the AER,[9] these errors (committed in the Guideline process) could certainly be corrected through the determination process.[10] APA observes that the regulated businesses have tried strenuously to demonstrate the errors in the Rate of Return Guideline in order to resolve these errors through the determination process (and thus negate the need to correct the errors through the merits review process).

However, where the AER's final decision continues to be affected by those errors, then it is important for the businesses to have recourse to review to ensure that those errors are corrected.

### 3.1.2 *Question 2: Are reviews generally considered a routine part of the determination process?*

APA considers that a decision of a commercial entity to challenge a decision of a duly authorised administrative decision-maker is not one to be taken lightly. Only where the business' interests are materially affected by a demonstrable error in the decision-maker's decision would a prudent Board of Directors undertake to challenge that decision.

In APA's experience, the costs of undertaking a merits review proceed are considerable, and not to be underestimated.

One of the concerns addressed in the 2013 reforms was that regulated businesses could recover the costs of merits review action through increases in regulated tariffs. This promoted the perception that a merits review

[9] NGR s87(18).

[10] Perhaps the most obvious of these is related to the value of Gamma (the value of tax imputation credits) for which the Tribunal has twice decided on the appropriate value, and which the AER has not adopted in its decisions.

activity was a "nothing to lose" proposition. However, in addition to the scope for intervenors to raise additional matters as discussed in section 3.1.2.1, the last set of reforms removed the scope for businesses to recover the costs of merits review activity through regulated tariffs, and added scope for the businesses to be required to bear the costs of intervenors:

> *269A—Costs not to be passed on*
>
> *(1) This section applies to any expenditure or cost that a service provider incurs, or is forecast to incur, as a result of or incidental to a review that relates to a designated reviewable regulatory decision under this Part, including costs awarded under section 268 [costs awarded to other parties].*
>
> *(2) A service provider—*
>
> *(a) must not, for the purposes of an applicable access arrangement decision, include as part of its capital expenditure or operating expenditure any expenditure or cost to which this section applies; and*
>
> *(b) must not recover from end users or seek a pass through of any expenditure or cost to which this section applies.*

Under the current LMR framework, a business seeking merits review must bear its own costs associated with correcting the errors in the AER's determination, but must also bear any costs awarded to intervenors or others through the process of the review.

APA considers that considerable (non-recoverable) costs to be borne through conducting a merits review process, and the risk of additional significant costs being levied as a result of a Tribunal decision, ensure that that merits review is not considered a routine part of the regulatory process.

That it is not viewed as a routine part of the regulatory process is demonstrated by APA not having pursued merits review in relation to the Regulators' final decisions for any of its businesses since the changes in 2013.Final decisions have been made in relation to Directlink, Amadeus and Goldfields Gas Pipeline in that time period.

#### 3.1.2.1 *The important role of the threat of interveners*

The 2012 Review of Limited Merits Review concluded that the (then) regime was vulnerable to "cherry picking". That is, for a business to lodge merits review proceedings on aspects on which the business asserts that the AER had erred against its interests, while neglecting to draw attention to any offsetting errors that AER may have made in the business' interests.

While the 2012 Expert Panel did not find evidence that "cherry picking" had been occurring,[11] it addressed this concern by implementing new provisions in the NGL:

> *256—Interveners may raise new grounds for review*
>
> *(1) An intervener may raise in a review under this Division any of the grounds specified in section 246 even if the ground that is raised by the intervener is not raised by the applicant.*

This provision was added to address the "cherry picking" concern. It allows the regime to ensure that both the "swings" and "roundabouts" are included in the overall assessment.

One important aspect of the 2012 review, which is neglected in the discussion paper, is the extent to which these initiatives have been effective.

In APA's view, a service provider, seeking to lodge an application for merits review, will be cautious in deciding to lodge such an application, knowing that consumers, users or consumer groups can raise other matters on which the AER has not, in the view of the service provider, erred.

This is particularly true for transmission businesses whose consumers are large organisations who are motivated, informed and have significant resources.

This presents an important discipline which has been overlooked in the current discussion paper. APA suggests that there may well have been opportunities for regulated businesses to lodge merits review applications which have not been pursued, as the business has considered the scope for intervenors to raise other matters. APA submits that this should be considered by the LMR Project Team in assessing the performance of the current LMR regime.

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[11] Review of the Limited Merits Review Regime - Stage Two Report, 30 September 2012, p31.

### 3.1.3 *Question 3: Does the framework enable reviews to focus primarily on the long term interests of consumers?*

In much of the material written in regards to the merits review process there is a tendency to confuse short term price outcomes with the "long term interests of consumers". It is important that the Team recognise that long term consumer interest is not served by driving down prices below their sustainable level.

Gary Banks, former Chairman of the Productivity Commission, articulated the issue succinctly:[12]

> *the Commission has ... signalled a need for greater legislative recognition ... of the tradeoff between cheap services today and inadequate services tomorrow.*

Put another way, low returns on invested capital will deliver lower current prices to today's consumers, but will be insufficient to attract investment to build the additional infrastructure required as the economy grows.

In APA's view, the AER's determinations have focused extensively on current price outcomes over long term infrastructure investment requirements, and in this respect have overly focused on the short term interests of consumers at the expense of the long term interests.

In contrast, the ACT's decisions have focused on the particular issue and the relevant legislative framework, without giving primary importance to the pricing outcomes.

In APA's view, the decisions of the ACT have reflected this tradeoff more effectively than the primary decisions of the AER, and have thereby more strongly focused on the long term interests of consumers.

[12] Gary Banks, '*The good, the bad and the ugly: economic perspectives on regulation in Australia*'. (Speech to the Conference of Economists, Business Symposium, Canberra, 2 October 2003) p7.

## 3.2 Material considered by the Tribunal

### 3.2.1 *Question 7: Are there any issues with the scale and scope of material that can be brought forward in relation to reviews?*

At the highest level, APA considers that, in order for the review body to be able to "step into the shoes" of the primary decision-maker, it must have before it all information that was available to the primary decision-maker. To the extent that the businesses provide extensive analysis and information to the AER in the determination process, then all this information must be before the review body in order for the review body to be able to assess whether a preferable decision exists, considering the information before the primary decision-maker.

In this respect (and subject to the discussion in response to Q9 below), APA supports the current provision[13] under which the review body is restricted from considering any information other than that which was before the primary decision-maker at the time of making the primary decision.

### 3.2.2 *Question 8: Is there a way to minimise the regulatory impost of maintaining a record of decision making as part of any future reforms?*

APA considers that, from a governance perspective, it is important for an administrative decision-maker to be able to identify the evidence relied upon, the judgements made, and the discretions exercised in reaching a decision that affects the interests of other parties.

For this key reason, APA considers that it is important for the AER to maintain (and be prepared to present) a record of its own decision-making process, which would then become the starting point for a review body's review. This was a recommendation of the 2012 Expert Panel.[14]

APA is conscious of differing views regarding the AER's stance and behaviour in a merits review proceeding, in particular whether the AER should "defend"

[13] NGL s261(1)(a).

[14] *Review of the Limited Merits Review Regime - Stage Two Report*, 30 September 2012, p35: "Requiring the primary decision maker to construct a 'record' of evidence collected during its evaluations which would then become the evidential/factual starting point for the review body's own work. Subsequent investigatory effort would then be incremental to that of the primary regulator, rather than *de novo*."

its decision, or simply allow the Tribunal to decide if its original decision is the most preferable. It should be noted that this "AER decision support" governance document need not attempt to justify any judgements made or discretions exercised (this is the function of the Final Decision document), but rather should form a map of where those judgements have been made and those discretions have been exercised.

One of APA's concerns with the AER's primary decision making has been the scope for the AER to depart from its own precedent.[15] This leads to inconsistency in regulatory decision-making, and investment uncertainty.

APA considers that it is incumbent on the AER, as Australia's specialist economic regulator for energy infrastructure businesses, to be able to demonstrate awareness of, and compliance with, its previous decisions, and those of relevant review bodies. Maintaining a clear record of the evidence collected and relied upon in its decision-making should add greater consistency to the decision-making process.

### *3.2.3 Question 9: Are there any barriers to the Tribunal seeking additional expert advice? If so, how could these barriers be addressed?*

APA acknowledges that some of the matters facing the Tribunal are complex, and require specific expertise or advice to be brought to bear. In this respect, APA considers the preferable course of action is to extend the target time frame under NGL s260(2) rather than to deliver a sub-standard decision.

## 3.3 Approach adopted in reviews and consumer consultation

At a high level, APA considers that, as the purpose of merits review is to deliver a more preferable decision that promotes the long term interests of consumers, consumers should be central to the process in order to clarify where their long term interests lie.

[15] An example is the AER not considering whether an "interval of delay" had occurred in the context of the Roma Brisbane Pipeline 2012-17 Access Arrangement decision (in which case the AER's late decision delayed implementation of a revenue increase), immediately followed by its decision on the Victorian Transmission System 2013-17 Access Arrangement, in which it insisted on confiscating revenue earned in the case of its late decision delaying a revenue decrease.

It is APA's view that the Project Team needs to have a clear distinction in its mind when considering consumers. The consumers directly connected to the transmission networks are large businesses. They have access to significant resources (including access to lawyers), they have familiarity with the regulatory framework and they are capable of making their concerns known in the context of the access arrangement or revenue determination process and subsequently in relation to merits review proceedings.

These businesses directly engage in the AER's consultations in relation to the transmission networks. They are also capable of putting in a coverage application for a pipeline or advocating in relation to light coverage decisions.

An example is, in 2010, BHP Billiton Nickel West Pty Limited initiated a review of the decision by the Western Australian Economic Regulation Authority to publish and approve its own access arrangement for the Goldfields Gas Pipeline (Electricity Review Board, Application No. 1 of 2010).

### 3.3.1 *Question 10: Is participation without legal representation possible? Are there barriers hindering full consumer participation in the review process?*

In considering this issue the Project Team needs to recognise the distinction between large consumers and their representatives and small consumer representatives.

In particular should the issue be sufficiently material to their interests large consumers are more than capable in engaging in the merits review process. It is difficult to perceive a requirement for legal representation would pose a barrier to participation for businesses like BHP, Caltex, BP, Origin or AGL.

As generally the transmission charge is not a very significant component of small consumers' gas bills participation by their representatives is less common in transmission access arrangement reviews than in regards to distribution determinations. APA will leave it to parties with more direct experience of small consumer involvement to address any potential barriers to their participation.

### 3.3.2 *Question 12: What are/were your expectations of how the Tribunal would consider the input from consumers?*

APA considers, at a high level, that if policy makers adopt a particular form of merits review (in this case limited merits review), then it is incumbent for all

parties wishing to engage constructively in that process to build sufficient competence to be able to participate in that form of merits review. A failure to engage in the prescribed form of merits review makes it difficult for the review body to demonstrate that it has taken the views of these participants into consideration.

### 3.3.3 *Question 13: How can parties provide the Tribunal with sufficient evidence to inform its decision making, while still supporting the Tribunal in its aim to conclude decisions within three months?*

Appellants, through their submissions to the Tribunal, can be relied upon to draw the Tribunal's attention to the documents on the record that demonstrates the AER's alleged error.

Further to the discussion in response to Question 8, APA considers that a clear audit trail of the information relied upon, the judgements made, and the discretions exercised by the AER in support of its primary decision would be a useful resource in assisting the Tribunal in achieving its target time frame. This would allow the Tribunal to focus on the relevant pieces of information required to focus its attention.

## 3.4 Delivery of regulatory certainty

### 3.4.1 *Question 14: What has been the impact of the extended timeframe of review processes? How could these impacts be addressed?*

APA considers that there are two perspectives to be considered:

1. The experience of the review process over the course of the National Gas Access Regime; and
2. The experience with the merits review processes currently in train.

Over the course of the National Gas Access Regime, encompassing the period under which the *National Gas Code* came into effect in 1997 and the period after the *National Gas Rules* came into effect in 2008, extended time frames have not been a major concern:

- reviews of proposed revised access arrangements have been conducted on a prospective basis (that is, in advance of the conclusion of the access arrangement in force);
- for the most part, the decisions of the regulator have been delivered close to prescribed time frames;

- where applications for merits review have been lodged, they have (consistent with NGL s247(1)) been lodged promptly; and
- where merits reviews have been conducted, they have, for the most part, been conducted and completed quickly, with the Tribunal often varying the original AER decision rather than remitting for reconsideration.

For example, the time lines in the cases of APT Allgas Energy and APA GasNet merits review processes[16] are instructive:

| APT Allgas | APA GasNet | Action |
|---|---|---|
| 17 Jun 2011 | 29 Apr 2013 | AER Decision under s64 of the *National Gas Rules* published |
| 8 Jul 2011 | 20 May 2013 | Application for merits review lodged |
| 12 Oct 2011 [2011] ACompT 11 | 5 Jul 2013 [2013] ACompT 4 | Australian Competition Tribunal grants leave to appeal |
| 21 Nov 2011 | 13 Aug 2013 | Hearings before the Australian Competition Tribunal commence |
| 11 Jan 2012 [2012] ACompT 5 | 18 Sep 2013 [2013] ACompT 8 | Australian Competition Tribunal releases its Decision to vary the AER's decision |

It is also important to note that, where an application for merits review has been lodged, the AER's decision comes into effect pending the outcome of the merits review proceeding.

However, the experience with the current NSW/ACT electricity network proceedings have been quite different, largely caused by:

- the two-stage regulatory review process implemented to accommodate the AER's "Better Regulation" reforms;
- the AER's process in conducting its review, particularly relating to delays in completing and publishing its operating cost benchmarking exercise;

[16] There are APA's most recent merits reviews of AER decisions.

- the complexity of matters brought to the Tribunal in the merits review proceedings;
- the Tribunal's decision to remit the decision back to the AER for re-consideration;
- the AER's decision to further appeal the Tribunal's decision to the Federal Court; and
- the uncertainty associated with the outcome of the Federal Court proceedings and any subsequent AER remittal decision.

APA considers that the extended time frames associated with the current review processes are atypical of the merits review regime in place. These extended time frames have been caused more by the unusual circumstances under which the primary regulatory reviews have been conducted rather than any flaws in the merits review framework. This is not a circumstance that would justify changes to the merits review regime.

As discussed in the context of Question 15 below, the cascading nature of merits review applications has largely been a function of the unusually long time frame associated with the first round of merits review applications under the new regime.

APA's experience has been that the merits review regime, in steady state operation, has contributed to regulatory certainty in reaching more preferable decisions in a short time frame.

# 4 Potential options

## 4.1 Option 1: Retain the Tribunal as the review body without legislative amendments (status quo)

APA considers that the current merits review regime is not "broken". As noted in part 1 of this response, the first round of merits reviews following the 2013 reforms has not yet run its course, it is not possible to ascertain whether the merits review regime is delivering positive outcomes in terms of:

- producing a more preferable NEO/NGO decision;
- improving the quality of, and adding to regulatory certainty in, future AER decision-making; or
- influencing the scope and content of future regulated business access arrangement proposals.

In this respect, APA considers that a case for change has not been made, and it is premature to contemplate major changes to the LMR framework. In this respect, the "status quo" should arguably be considered to be the preferred course if and until a case for change can be made.

This is not to say that our experience with the LMR framework to date has not indicated, at this early stage, that there is scope for some improvement.

### 4.1.1 *Question 15: What would be the impact of maintaining the current regime?*

One of the features of the current regime is that a decision to impose a Guideline is not a "reviewable decision". That is, where the AER makes one or more errors in the development of a Guideline, these errors cannot be addressed until the Guideline is applied in the context of a "reviewable decision".

In the case of the AER's Rate of Return Guideline in particular, this has led to a number of overlapping merits review applications on the same matters. Where (as in the current circumstance) the matter under review is not finalised before the next round of regulatory decisions is published, the next set of businesses need to lodge merits review applications in order to ensure the Tribunal's decision can be applied in their circumstance. This results in a cascade of merits review applications on largely the same set of outstanding matters.

To the extent a Guideline remains a decision that is not subject to merits review, this feature of overlapping and cascading merits review applications can be expected to occur each time an error in the Rate of Return Guideline is identified.

APA considers that this is one area in which our early experience with the limited merits review regime indicates scope for positive change.

## 4.2 Option 2: Retain the Tribunal as the review body with legislative amendments

This option is APA' clear preference, with legislative amendments to include the AER's Guidelines among the list of reviewable decisions, as discussed above.

### 4.2.1 *Question 16: What amendments, if any, would you propose to achieve the policy intent of the 2006 and 2013 LMR reforms?*

In addressing this question, it is important to have a clear understanding of the policy intent behind the 2006 and 2013 reforms. As outlined in the Terms of Reference for this review, the limited merits review regime is "to ensure that relevant decisions promote efficient investment, operation and use of energy infrastructure, and are consistent with the revenue and pricing principles of the NEL and NGL, in ways that best serve the long-term interests of consumers."[17]

As discussed above, it is not clear that the current limited merits review regime has failed to meet the stated policy objectives.

However, APA is of the view that there is scope to investigate some legislative amendments to improve the operation of the regime as it relates to regulatory and investment certainty, particularly in relation to the determination of the cost of capital.

#### 4.2.1.1 *Changing the AER's cost of capital Guideline to a reviewable determination in its own right*

As noted in section 3.1.1, currently the AER issues a cost of capital guideline that is not binding on either the AER or the businesses. This has produced occasions when multiple businesses can be seeking error correction on the same topic.

[17] CoAG Energy Council, *Limited Merits Review Terms of Reference*, 19 August 2016, p2.

A solution to this issue that is worth further consideration is to change the guideline into a reviewable determination. That is the AER issues a Cost of Capital determination. The businesses and AER are then bound by this determination for the next five years. Given the importance of this decision it needs to be subject to merits review to rectify any Regulator error. But this would remove multiple appeals across time on cost of capital as is currently being experienced.

## 4.3 Option 3: Replace the role of the Tribunal with a new investigatory body

APA does not support the creation of a new merits review body. In APA's experience and observation, the Australian Competition Tribunal (ACT) has demonstrated a clear ability to grasp the complex technical issues under review, and has availed itself of expert advice where required.

APA notes that the ACT is the designated merits review body created under Part III of the *Competition and Consumer Act 2010*. To replace the Tribunal with a new body would require significant structural legislative change to the *Competition and Consumer Act*, which is clearly not warranted considering, as discussed above, that the case for significant change to the limited merits review regime has not been made.

### *4.3.1 Question 17: Should the existing Tribunal review process be made more investigatory in nature? If so, how could this be achieved?*

APA considers that it is not necessary to make the Tribunal review process more investigatory in nature- the current limited merits review regime already has sufficient scope for the Tribunal to seek advice and undertake investigations as it requires.

As discussed above, APA considers that the limited merits review process could be made more robust by having a clear governance record of the AER decision-making process (see the discussion in response to Q8), and providing greater encouragement to the Tribunal to avail itself of its current powers to seek advice as required (see the discussion in response to Q9).

## 4.4 Option 4: Remove access to LMR

APA outlines why it is opposed to the removal of LMR in section 2 of this response.

### 4.4.1 *Question 23: What are the likely consequences of removing access to merits review of revenue determinations and access arrangements? If access to LMR was removed, are there any complementary changes to the wider regulatory frameworks, or other legislative changes, that might be considered to provide accountability for regulatory decisions and deliver the long term interests of consumers?*

APA considers that reliance on judicial review alone would be a significant retrograde step for consumer involvement. In particular, APA considers that the narrow focus on matters of legal interpretation, would remove the "long term interests of consumers" from the equation.

*Administrative Decisions (Judicial Review) Act* allows for a narrow range of "error" to be corrected:

- Procedural ultra vires;
- Relevant and irrelevant considerations;
- Unreasonableness and illogicality;
- Error of law on the face of the record;
- Error of law and review of findings of facts; and
- Inflexible application of policy

Importantly, the scope for judicial review application does not include correction of errors of judgement or discretion.

The key question to be asked then, is in what kinds of ways is the AER likely to err in a judicial review context, such that access to judicial review alone would address the concerns of stakeholders campaigning for merits review?

In particular, would judicial review be a sufficient avenue for aggrieved persons to appeal on the exercise of discretion by the AER?

Acknowledging that the role of an administrative decision-maker such as the AER is to exercise judgement, the MCE recognised that judicial review errors were likely to fall into a number of key categories:[18]

- non-observance of procedures required by law to be observed;

[18] Ministerial Council on Energy Standing Committee of Officials, *Review of Decision-Making in the Gas and Electricity Regulatory Frameworks – Discussion paper.* 10 October 2005, para 2.43.

- error of law;
- lack of evidence or other material to justify the making of the decision.

There is a further question of the extent of prescriptiveness that would be required in the *Laws* and *Rules* in order to sustain an application for judicial review.

APA has conducted a high level review of a range of ACT decisions (particularly decisions in which error has been found) to assess whether grounds of review could have been established under a "judicial review only" model.

If grounds for review were established under criteria that would be available under the ADJR Act, then it may be an indication that judicial review may have been sufficient.

However, if the ACT accepted grounds for review that would not have been accessible under the ADJR Act, then this would be an indication that judicial review alone would not have been sufficient to provide adequate scope for review of the AER's decisions.

APA concludes from this review that, while there were some cases presented in which the grounds for review could have been stated in judicial review terms, it is clear from the analysis that there were many cases presented that relied on a framework to test the merits of the AER's decisions rather than their lawfulness.

Judicial review would clearly have been an inadequate tool to correct errors in these AER determinations.

### *4.4.2 Question 25: Should all access to merits review be removed or only for electricity revenue determinations and gas access arrangement decisions?*

APA considers that the focus of merits review has been on revenue and pricing determinations by the AER. However, the National Gas Access Regime includes two other key decisions that are subject to merits review:

1. Coverage decisions by the relevant Minister; and
2. Light regulation decisions by the National Competition Council.

APA considers it if critical importance to the integrity of the Gas Access Regime that merits review continues to be available for these decisions.

The ACCC, in its *East Coast Gas Market Review*, recommended a review of the coverage test under the national gas Law. At its meeting of 19 August, the CoAG Energy Council accepted that recommendation, and adopted Energy Council Reform Measure 4:

> *4. Examine the pipeline coverage criteria in the NGL*
>
> *Examine the current regulatory test for the regulation of gas pipelines, in consultation with stakeholders, and provide recommendations on any future action to the Energy Council, including potentially replacing the test.*

It will be critically important for the ongoing integrity of the gas access regime that merits review remains available for Ministerial coverage decisions, in order to ensure that the CoAG policy intent is correctly reflected in those decisions.

It is noteworthy that the ACCC, in its East Coast Gas Market Inquiry report, supports retention of merits review as an important safeguard to investment in gas transmission infrastructure:[19]

> *[p12] The Inquiry is cognisant of the effect that regulation can have on investment, innovation and the other costs and risks that regulation can expose parties to. There are, however, already sufficient safeguards in the NGL and NGR that are designed to ameliorate these effects, including, amongst others, the 15-year no-coverage option for greenfields pipelines, the protection the NGL accords commercially negotiated contracts, the possibility of full or light handed regulation and the availability of merits review. The Inquiry is not recommending any changes to these elements of the current regime.*

…

> *[p122] The NGL also includes a merits review mechanism, which is designed to minimise the risk of regulatory error in relation to coverage, form of regulation and access arrangement decisions. In addition to this safeguard, the NGL protects pre-existing contractual rights and allows parties to reach alternative*

[19] ACCC, *Inquiry into the east coast gas market*, April 2016.

*arrangements to those set out in an access arrangement. The protection of contractual rights means new pipelines and other investments can still be underwritten by shippers through medium- to long-term GTAs, which reduces regulatory related investment risks.*

...

*[pp 137-138] While regulation can have these effects [deterred investment in pipelines, delayed construction of pipeline infrastructure, front-loading of transportation charges], there are already a number of safeguards in the NGL and NGR that are designed to counter these effects, including: ...*

- The merits review provisions, which apply to decisions to regulate a pipeline, light regulation determinations and regulatory decisions by the AER.

*The Inquiry can see the value of these significant safeguards and is not suggesting that any of these safeguards be removed.*

# A Attachment A: should the decisions of the AER be subject to merits review?

The Administrative Review Council (ARC) has developed a rigorous framework for assessing whether a decision should be subject to merits review, and this framework is encapsulated in its booklet, *What Decisions Should be Subject to Merits Review?*[20] The principles espoused in this widely referenced booklet have been developed by the Council in the course of advising the Attorney-General on the classes of administrative decisions that should be subject to merits review. The Council applies these principles to each class of decision under consideration. The Council advises:[21]

> *The Council's guidelines are often applied in assessing whether the Administrative Appeals Tribunal ('AAT') should be given statutory jurisdiction to review a particular type of decision. They are, however, equally applicable in deciding the appropriate jurisdiction of other persons or bodies who engage in independent or external merits review.*

The ARC filed a submission[22] to the MCE in the context of the its 2006 Decision Paper, Review of decision-making in the gas and electricity regulatory frameworks. While recommending full merits review to the Australian Competition tribunal (ACT) for the economic regulatory decisions of the AER in relation to gas and electricity, the ARC's submission was structured to address a series of questions posed by the MCE Standing Committee of Officials; it did not address itself to the first-principles question of whether the AER's decisions should be subject to merits review.

This section follows the framework established by the AER and investigates whether, based on the application of that framework, the AER's decisions should or should not be subject to merits review.

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[20] ARC, *What Decisions Should be Subject to Merits Review?* www.arc.ag.gov.au

[21] ARC, *What Decisions Should be Subject to Merits Review?* Para 1.9.

[22] ARC, *Submission to the Ministerial Council on Energy Discussion Paper 'Review of Decision-Making in the Gas and Electricity Regulatory Frameworks'*, 8 November 2005.

## A.1 Identifying a merits reviewable decision

In its submission to the MCE, the ARC stated:[23]

> *The Council considers that the following decisions should be subject to merits review:*
>
> - *AER decisions to draft and approve access arrangements in relation to gas;*
> - *Ring fencing decisions by the AER in relation to gas;*
> - *The relevant Ministers decisions in relation to coverage of gas pipelines; and*
> - *The economic regulatory decisions of the AER in relation to the setting of revenue caps for transmission network service providers, and ultimately distribution network service providers, in the electricity industry.*

A review of NEL s71A and NGL s244 indicates a sound alignment between the ARC's recommendations and the currently defined reviewable decisions. It should be noted that, for the AER's economic decisions, it is the final revenue decision that is subject to merits review.

## A.2 Are the AER's decisions unsuitable for merits review?

The ARC identifies a number of decision types that are unsuitable for merits review, as discussed below.

| Factors that make decisions unsuitable for merits review | |
|---|---|
| Legislation-like decisions - those that apply generally to the community, or to a broad class of persons.[24] | The AER has no Rule making powers or responsibilities; its decisions would not fall under this exemption.<br><br>The AER's economic regulatory decisions relate to particular service providers; even where common issues are assessed together, a separate decision is issued for each. These are not legislation-like decisions, and are therefore not unsuitable for merits review. |

[23] ARC, Submission to MCE, p5.

[24] ARC, *What Decisions Should be Subject to Merits Review?* Para 3.3-7.

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| Automatic or mandatory decisions. | The AER's decisions on network revenues or prices is the culmination of an extensive analysis, review and consultation process conducted over many months. In this respect, it could not be considered an automatic or mandatory decision |
| **Factors that may justify excluding merits review: Factors lying in the nature of the decision** | |
| Preliminary or procedural decisions | |
| Decisions to institute proceedings | The AER's economic regulation decisions would not reasonably be considered decisions to initiate proceedings. However, the AER has powers under the NEL and NGL to institute or commence proceedings related to breaches of the relevant laws.[25] These decisions are not reviewable decisions under the NEL or NGL. |
| Decisions allocating a finite resource between competing applicants, in which:<br>- there is an allocation of finite resources; and<br>- an allocation that has already been made to another party would be affected by overturning the original decision. | Particularly to the extent that network service providers operate as monopoly businesses within defined service territories, the AER's economic regulatory decisions would not fall under this exemption category. |
| Decisions relating to access to parliamentary or judicial records | As the AER's economic regulatory decisions do not involve access to core parliamentary or judicial records, this exemption does not apply. |
| Policy decisions of a high political content | The ARC addressed this in the context of coverage decisions under the Gas Access Regime, noting "while some policy decisions of a highly political content may not be suitable for merits review, it is rare that decisions fall within this exception."[26] |
| Decisions of a law enforcement nature | While the AER has extensive information gathering powers under the NEL and NGL, including powers to authorise persons to apply for and execute search warrants, and to seize documents,[27] it would not be reasonable to characterise these, or its economic regulation decisions, as decisions of a law enforcement nature. |

[25] NEL s58 et seq; NGL s27.

[26] ARC, *Submission to MCE*, p8.

[27] NEL s19 et seq; NGL s31 et seq.

| | |
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| Financial decisions with a significant public interest element | To the extent there is considerable overlap between the "consumers of electricity (or gas)" and "the public", it could be argued that the NEL and NGL require the AER to make its decisions with the long term interests of the public as a priority. |
| **Factors that may justify excluding merits review: Factors lying in the effect of the decision** | |
| Decisions to delegate a power or to appoint a person to undertake a specified function | The ARC advises that a decision to delegate authority does not, in itself, affect any person's interests and therefore should reasonably not be subject to merits review.[28]<br><br>S44AAH of the *Competition and Consumer Act* gives the AER powers to delegate its functions, but only to an AER member or to an SES employee assisting the AER.<br><br>This does not appear to be a decision that affects interests, and should reasonably not be subject to merits review. |
| Recommendations to ultimate decision-makers | The ARC notes that a recommendation to an ultimate decision-maker is not a "decision" and therefore should not be subject to merits review.[29] This is because the recommendation does not directly affect a person's interest - the decision subsequent to that recommendation is the reviewable decision.<br><br>The AER, as an independent regulator, does not make recommendations to another decision-maker; it is the economic regulation decision-maker. In this regard, the nature of the AER's economic regulatory decisions would not justify excluding access to merits review on these grounds. |
| Decisions where there is no appropriate remedy | The ARC identifies two types of decision for which there may be no appropriate remedy: an irrevocable decision, such as to destroy documents, or a decision with such a short applicability that the effect of the decision would be finalised before a review could be heard.[30]<br><br>In the case of the AER's economic regulatory decisions, the decision applies to a forecast period, generally over five years. The AER's decision is made before the commencement of the forecast period.[31] |

[28] ARC, *What Decisions Should be Subject to Merits Review?* Para 4.43.

[29] ARC, *What Decisions Should be Subject to Merits Review?* Para 4.44-48.

[30] ARC, *What Decisions Should be Subject to Merits Review?* Para 4.49-51.

[31] NER s6.11, NGR s62(6), s64(6).

| Factors that may justify excluding merits review: Factors lying in the costs of review of the decision | |
|---|---|
| Decisions involving extensive inquiry processes | It can be readily acknowledged that the AER's economic regulatory decisions are the output of an extensive and robust inquiry process.<br><br>The MCE's response to this concern was to implement a form of limited merits review which did not involve a de novo review of the AER's decision. Rather, the party lodging the application for review specifies the matters for which it seeks review. While the AER and intervenors are allowed to add other matters, the Tribunal's review is initially focused on these matters.[32] This focuses the review and addresses the cost concern. |
| Decisions which have such limited impact that the costs of review cannot be justified | The value under review in the current NNSW and Jemena Gas Networks decisions is clearly well in excess of the cost of the merits review process. |
| **Factors that do not justify excluding merits review: Factors lying in the nature of the decision** | |
| Decisions affecting the national sovereignty or prerogative power (eg decisions on migration as an example of a decision affecting national sovereignty) | The AER's economic regulatory decisions do not affect national sovereignty or prerogative power. |
| Decisions made, or reviewed, in geographically isolated places | The AER maintains an office in each mainland state and meets in those states at least once every eighteen months. The Australian Competition Tribunal generally convenes in Melbourne, but has held hearings in Sydney and Brisbane.<br><br>This exemption would not apply to the AER's economic regulatory decisions. |
| Decisions that are legislatively unstructured | While the AER has broad discretions in making its regulatory decisions, the structure under which those decisions are made, and the nature of the discretions available, are clearly outlined in the NEL and NER, and the NGL and NGR. |
| Decisions made by reference to government policy | The AEMA is clear that matters of government policy are reserved for the MCE (now CoAG Energy Council), the AEMC is responsible for developing Rules to reflect that policy, and the AER's role is limited to applying the applicable Rules.[33] The AER's decisions are therefore not made by reference to |

[32] See NELs71A et seq ; NGL s246 et seq.

[33] *Australian Energy Market Agreement*, 02 July 2009.

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| | government policy. It should be acknowledged, however, that the AER may refer to government policy to guide its exercise of discretion. |
| **Factors that do not justify excluding merits review: Factors lying in the nature of the decision-maker** | |
| The decision-maker is an expert, or requires specialised expertise | It can readily be acknowledged that the AER is Australia's expert body in the regulation of monopoly energy infrastructure.<br><br>However, the ARC advises that this alone is not a reason for its decisions to be exempt from merits review.[34] While the ARC notes that experts can be appointed to the review body, the existing Australian Competition Tribunal is already recognised as expert in the field.[35] |
| The decision-maker is of a high status | The ARC discusses "high status" in terms of a Minister, or the Governor-General.[36]<br><br>The AER is a body corporate established under s44AAE of the *Competition and Consumer Act*. It is not clear how a corporate body could be considered to be of high status; this avenue of exemption would not apply. |
| **Factors that do not justify excluding merits review: Factors lying in the effect of the decision** | |
| Review may lead to the publication of reports affecting individuals | The regulatory framework in which the AER operates has rigorous protocols for the management of confidential information.[37] In practice, both the AER and the Tribunal have published redacted versions of decisions to protect the identity of particular persons.<br><br>Both the NEL and NGL provide that decisions relating to the disclosure of confidential information are not reviewable. |
| Large numbers of people may take advantage of review | The ARC advises that the fact that large numbers of people may take advantage of the opportunity for review should not, in itself, preclude the decision from review. Rather, the ARC recommends other caseload management techniques be applied.[38]<br><br>Indeed this is precisely what the MCE did in implementing its limited form of |

[34] ARC, *What Decisions Should be Subject to Merits Review?* Para 5.17-19.

[35] Ministerial Council on Energy, *Review of Decision-Making in the Gas and Electricity Regulatory Frameworks – Decision*, May 2006, p4.

[36] ARC, *What Decisions Should be Subject to Merits Review?* Para 5.20-23.

[37] See *Competition and Consumer Act* s44AAF, NEL s18, s28W et seq; NGL s30, s324 et seq.

[38] ARC, *What Decisions Should be Subject to Merits Review?* Para 5.28-29.

| | |
|---|---|
| | merits review. The MCE imposed three key hurdles before the ACT would grant leave for review:<br><br>- the amount at issue exceeds $5 million or 2% of the annual regulated revenue of the applicant; and<br><br>- the Tribunal is satisfied there is a serious issue to be heard and determined.<br><br>- the decision would, or would be likely to, result in a materially preferable designated NEO/NGO decision<br><br>The Tribunal must also refuse to grant leave is submissions were not made, or were made late.[39] |
| There is potential for the original decision to be subject to judicial review | As discussed above, judicial review of administrative decision making is protected by s75(v) of the Constitution. As succinctly stated by the ARC in its submission to the MCE:[40]<br><br>"It is the Council's view that judicial review is complementary to, but distinct from, merits review.<br><br>"Judicial review is concerned with the legality of a decision. Provided that an exercise of discretion by an energy regulator was within the broad parameters set by the law, any error of fact, or applying an inappropriate economic formula in the circumstances, would not be corrected by judicial review." |

## A.3 Summary

The analysis above, addressing each of the ARC's 24 criteria in turn, indicates an overwhelming preference for the AER's economic regulatory decisions to be subject to review on the merits.

In those areas where the AER's decisions are not well-suited to merits review, for example regarding the expertise of the decision maker, or the scope for a large number of reviews to be sought, the limited form of merits review currently embodied in the NEL and NGL have been designed to address concerns arising.

[39] NEL s71C-G; NGL s248-250.

[40] ARC, *Submission to the Ministerial Council on Energy Discussion Paper 'Review of Decision-Making in the Gas and Electricity Regulatory Frameworks'*, 8 November 2005. p4, 5.