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Email Letter

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Our Ref RJG:7231529

Dear Mr Hickey

Applications under section 71B of the National Electricity Law for a review of distribution determinations made by the AER in relation to United Energy Distributions Pty Ltd, CitiPower Pty Ltd, Powercor Australia Ltd, Jemena Electricity Networks (Vic) Ltd and AusNet Electricity Services Pty Ltd pursuant to Rule 6.11 of the National Electricity Rules

Australian Competition Tribunal Proceedings No ACT 3, 4, 5, 7, 8 of 2016

In accordance with the Tribunal's order dated 21 June 2017, we enclose Energy Consumers Australia Ltd's written submission to the Tribunal addressing the implications of the decision of the Full Court in *Australian Energy Regulator v Australian Competition Tribunal (No 2)* [2017] FCAFC 79.

Yours sincerely

Robert Gregory
Partner

Commonwealth of Australia

National Electricity (Victoria) Act 2005
National Gas (ACT) Act 2008

In the Australian Competition Tribunal

File Nos: ACT 3, 4, 5, 7 and 8 of 2016

Re: Applications under section 71B of the National Electricity Law for a review of distribution determinations made by the Australian Energy Regulator in relation to United Energy Distribution Pty Ltd, Citipower Pty Ltd, Powercor Australia Ltd, Jemena Electricity Networks (Vic) Ltd and Ausnet Electricity Services Pty Ltd pursuant to clause 6.11 of the National Electricity Rules

Applicants: United Energy Distribution Pty Ltd (ABN 70 064 651 029) (ACT 3 of 2016) (**United Energy**)
Citipower Pty Ltd (ACN 064 651 056) (ACT 4 of 2016) (**Citipower**)
Powercor Australia Ltd (ACN 064 651 109) (ACT 5 of 2016) (**Powercor**)
Jemena Electricity Networks (Vic) Ltd (ABN 82 064 651 083) (ACT 7 of 2016) (**Jemena**)
Ausnet Electricity Services Pty Lt (ACN 064 651 118) (ACT 8 of 2016) (**Ausnet**)

File No: ACT 6 of 2016

Re: Application under section 245 of the National Gas Law for a review of full access arrangement decision made by the Australian Energy Regulator in relation to ActewAGL pursuant to clause 64 of the National Gas Rules

Applicant: ActewAGL Distribution Pty Ltd (ABN 76 670 568 688)

WRITTEN SUBMISSIONS OF ENERGY CONSUMERS AUSTRALIA LTD

RE: IMPLICATIONS OF THE DECISION IN *AUSTRALIAN ENERGY REGULATOR V AUSTRALIAN COMPETITION TRIBUNAL (NO 2)* [2017] FCAFC 79

Filed on behalf of (name & role of party) Energy Consumers Australia Ltd
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INTRODUCTION

1. Energy Consumers Australia Ltd (**ECA**) is an independent organisation that was created by the Council of Australian Governments to give energy consumers, in particular residential and small business energy consumers, a national voice in the energy market. ECA was represented by its CEO, Rosemary Sinclair, in the Tribunal's consumer consultation that took place on 6 October 2016, pursuant to s 71R(1)(b) of the National Electricity Law (**NEL**)[1].

2. ECA now makes these written submissions regarding the implications of the Full Court of the Federal Court of Australia in *Australian Energy Regulator v Australian Competition Tribunal (No 2)* [2017] FCA 79, pursuant to the direction of the Tribunal made on 21 June 2017.

OBSERVATIONS REGARDING THE LITIGATION ON GAMMA

3. The applicants in ACT 3 to 8 of 2016 filed joint submissions dated 26 September 2016 in relation to the value of imputation credits (gamma).

4. In their joint submission, the applicants stated at [17] that:

> *The issues raised in the Applicants' respective applications in relation to gamma are substantially the same as the issues raised by each of the NSW/ACT businesses and SA Power Networks in their recent applications to the Tribunal. The AER's decisions for the Applicants on this topic are also substantively the same as the decisions it made for each of the NSW/ACT businesses and SA Power Networks, except that the present decisions under review contain some additional matters included in response to the Tribunal's decision in the NSW/ACT proceedings.*

5. In the present application, and each of the applications to the Tribunal by the NSW/ACT businesses and the SA Power Networks, the AER had adopted a gamma value of 0.4, while the applicants contended for a gamma of 0.25. As the applicants themselves have contended, each of the applications raised substantially the same issues, in respect of substantially the same determination by the AER.

6. In the NSW/ACT Tribunal Decision, the Tribunal found that the AER had made reviewable errors in adopting a gamma value of 0.4, and directed it to apply the gamma

[1] A reference to the NEL should be taken to also include a reference to the equivalent provision in the National Gas Law.

value of 0.25[2], contended for by the applicants in that proceeding, and also the Applicants in the present proceeding.

7. However, in the SA Power Networks Tribunal Decision[3], the Tribunal found that the AER had ***not*** made any reviewable errors, when adopting the same gamma value for substantially the same reasons.

8. Now, on appeal from the NSW/ACT Tribunal Decision, the Full Court of the Federal Court has overturned the Tribunal's findings in relation to gamma, and held that the AER did not make any error when adopting a gamma value of 0.4. Critically, the Full Court held that it was not a reviewable error for the AER to prefer its own theoretical approach to considering the determination of gamma over the competing theoretical approach favoured by the applicants, provided it did not commit any other error in doing so, and it did not act on any economic learning that fell outside the mainstream of the discipline.[4]

9. In those circumstances, the Tribunal is bound by the decision of the Full Court. In the absence of any development in economic theory, or the intrusion of some other distinguishing factor, the Full Court has resolved that:

   (a) the AER has discretion in respect of its theoretical approach to gamma; and

   (b) the adoption of a gamma value of 0.4 on the basis of the AER's preferred theoretical approach is a defensible one.

10. Two important observations can be made from the history of litigation on gamma.

11. The first observation is that, hypothetically, if the Tribunal ***were*** to require the adoption of a gamma value of 0.25, as the Applicants are contending, that result would mean substantial additional revenue to the Applicants, and a corresponding increase in the price paid by energy consumers.

12. That this could occur without any directly corresponding increase in quality, reliability, security or safety for consumers is a powerful indication that the Tribunal should be very cautious before finding that a materially preferable NEO decision within the meaning of s 71P(2a) will result from the correction of error, or the adoption of one economic model

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[2] *Applications by Public Interest Advocacy Service Ltd and Ausgrid Distribution* [2016] ACompT 1 **(NSW/ACT Tribunal Decision).**

[3] *Application by SA Power Networks* [2016] ACompT 11 **(SA Power Networks Tribunal Decision)**.

[4] *Australian Energy Regulator v Australian Competition Tribunal* ***(AER v ACT)*** *(No 2)* [2017] FCAFC 79, [756]

over another. Rather, the Tribunal ought only to be satisfied with an outcome resulting in additional revenue for a network business (and a corresponding increase in energy prices) if the business has clearly identified real and substantial improvements to quality, reliability, security or safety in the long-term interests of consumers that would serve to justify such an increase.

13. The second observation is that gamma has been a consistently-fought issue because the substantial additional revenue a shift in gamma from 0.4 to 0.25 would generate for the network businesses amply justifies their cost of litigation.

14. In its final decision, the AER noted that it had adopted the lower gamma value of 0.4, and not the value of 0.5 recommended by its own expert Dr Martin Lally. It did so expressly in order to provide '*regulatory certainty and predictability*' – presumably to promote the safety, reliability and security of supply, but also to the effective benefit of the network businesses.[5]

15. Arguably therefore, the appropriate gamma value may be even higher than the figure which the AER has adopted over the applicants' objections. Where the network businesses may be assumed (and observed in practice) to routinely litigate in their own self-interest in such circumstances, energy consumers do not have the means or the immediate financial incentives to do so. The Tribunal should not be quick to find that correcting every alleged error in favour of the network businesses' increased revenue is necessary to achieve an optimally efficient balance between price, quality, reliability, security and safety. Rather, the relatively stronger incentives for network businesses to engage in self-help, as compared to other stakeholders, will tend to increase revenues at the expense of optimally efficient pricing in any event.

THE MATERIALLY PREFERABLE NEO DECISION TEST

Rectification of errors not sufficient

16. Further to the points made above in relation to gamma, at [152] of the Full Court's judgement, the Court accepted that there was an *'implicit statutory premise'* that the mere rectification of errors may not lead to a decision that is materially preferable to that originally made by the AER, because if that were the case then NEL s 71P(2a) would have no work to do. Further, at [156], the Full Court accepted that the *Statutes Amendment (National Electricity and Gas Laws – Limited Merits Review) Act 2013* (SA)

[5] AER, United Energy final decision 2016-20, Overview, 23.

was directed to the mischief of "cherry picking" errors in individual components of a decision.

Appeal only to be allowed where the economic interests of the network business coincide with the long term interests of consumers

17. The need for caution against a focus on finding and rectifying 'errors' is particularly powerful given the process by which errors are selected to be appealed, and the network businesses' economic incentives to do so. An appeal to the Tribunal is brought by a network business to advance its economic interests – typically to increase its allowable revenue, with the consequent effect of higher prices for energy consumers. However, the impact of the materially preferable NEO decision test is that an appeal is only to be allowed if the network business's economic interests in pursuing the appeal ***coincides*** with the long term interests of consumers. That is, an increase in revenue can only be justified as a 'materially preferable NEO decision' if any detriment to the long term interest of consumers in relation to affordable pricing is counterbalanced by a commensurate increase in quality, safety, reliability and/or security of supply.

18. Further the Full Court held that, in order to be 'materially preferable', the future decision that is intended to replace that originally made by the AER must be *'preferable to an important degree or extent'*: at [153]. The importance, or otherwise, must be judged by reference to the NEO – that is, the degree of improvement between the original decision and that which will replace it must be important to the ***long term interests of consumers*** with respect to price, quality, safety, reliability and security of supply. The degree of importance to the network business may be indirectly relevant if it also promotes the long term interests of consumers, but it is not the primary focus of the test.

Tribunal must consider specific outcomes

19. The Full Court stated that, before setting aside and remitting a determination, the Tribunal must be satisfied that doing so will *'more likely than not'* result in a materially preferable NEO decision. Before specifically varying the AER's determination, the Tribunal must have *'a high degree of certainty'* that a materially preferable NEO decision would be achieved.[6] Regardless of which standard applies, in each case the Tribunal must have formed a sufficiently clear view about the outcome that is likely to result.

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[6] *AER v ACT (No 2)* [2017] FCAFC 79, [154]-[155].

20. In forming such a view, the Tribunal's task requires that it take into account any other negative impact that a variation or re-determination is likely to have on the interests of consumers. For example, it must consider the pressure on household budgets if an upwards revision in revenue occurs part-way through a regulatory control period. In that event, the impact of relatively lower prices under the first years of the AER's original determination will presumably be recouped by the imposition of disproportionately high prices in the later years of the period, to ensure that the new allowable revenue is averaged out over the regulatory control period as a whole. That is particularly relevant where consecutive appeals to the Tribunal and subsequently the Federal Court may result in a substantial delay between the AER's original determination and the coming into effect of any decision to vary or replace it.

Caution regarding statements made by the Tribunal in the NSW/ACT Tribunal Decision

21. Finally, the Full Court stated at [277] that the Tribunal was an administrative body, not a court, and that it would not seek to construe the Tribunal's written reasons *'minutely and finely with an eye keenly attuned to the perception of error.'* As a practical matter, it similarly follows that every statement of the Tribunal cannot now be regarded as having been positively approved by the Full Court.

22. For example, the NSW/ACT Tribunal Decision states as follows at [465] – [466]:

> *The 2012 Rule Amendments together with the 2013 Legislative Amendments give rise to a multifaceted regulatory regime calling for a **balance** between the interests of consumers on the one hand and the interests of DNSPs on the other.* (emphasis added)

23. If taken in isolation, it is respectfully submitted that statement is incorrect. The regime does not call, either expressly or by implication, for a balance between the interests of consumers and network businesses. Rather, the NEO is expressly to promote efficient investment in, and operation and use of, electricity services ***for the long term interests of consumers***: see NEL s 7. The interests of the network businesses are to be advanced if and only to the extent that they coincide with, and are instrumental to achieving, the long term interests of consumers as promoted by the NEO – but no further.

M B PECKHAM

22 June 2017