Review of Limited Merits Review

ECA submission to Review of LMR Consultation Paper

October 2016

Energy Consumers Australia

Introduction

Energy Consumers Australia (ECA) welcomes the opportunity to respond to the *Review of the Limited Merits Review (LMR) Regime Consultation Paper* (the **Consultation Paper**).

ECA is tasked with providing and enabling advocacy on matters of national significance to residential and small business consumers to support the overall market objective to promote the long term interests of consumers with respect to price, quality, safety, reliability and security of supply.

ECA believes there is a strong case for change to the current LMR regime, and we welcome the Energy Council's intention to speedily progress this review.

The most recent round of network appeals show that the LMR remains a costly and legalistic process. Further, the Australian Competition Tribunal (The Tribunal) has not moved away from 'error finding and correction', to the more holistic, consumer-orientated approach contemplated by the Expert Panel in 2012. We do however remain open-minded about how this might be addressed. Accountability in regulatory processes – particularly where there is discretion on the part of an economic regulator – is important; not just for business interests but also for consumers.

We are conscious that the review mechanisms, while important, are only one part of a bigger regulatory framework. ECA is firmly of the view that many of the issues that manifest at the appeals stage are symptomatic of problems earlier in the regulatory process for revenue determinations. In an energy market that is being disrupted by new technology, where consumers are becoming much more active and that is facing the challenge of decarbonisation, we cannot continue to fall back on adversarial legal processes if networks are to move forward.

ECA's own approach to this consultation is informed by three simple propositions.

1. To achieve the *long-term interests of energy consumers* (LTIC) objective, we need a regulatory framework that supports strong, successful and sustainable network businesses. The interests of the network businesses and consumers are not in competition, nor is the task of the regulator is to weigh one against the other, with the consumer playing the role of the 'contradictor' of networks' claims as some have recently suggested. The objective of network regulation, and any review mechanism, must be to facilitate a mutually beneficial alignment of interests.
2. ECA recognises the importance of regulatory certainty and stability and the need to ensure that networks remain attractive investments. These investments are, however safe secure 'utility stocks' providing a stable return, not 'growth' stocks.
3. ECA does not seek the lowest prices *per se*, but assurance through the regulatory processes that consumers are paying no more than is necessary for their energy services.

In making this submission, ECA's objective therefore is to provide the Project Team with a consumer perspective on the performance of the LMR regime – in particular the extent to which the policy intent of the 2012 Review and the subsequent legislative amendments have been met – and to explore options to address these issues.

The consumer context

The views that we express in this submissions about the performance of the Limited Merits Review regime (LMR) are informed by extensive experience of the process.

ECA provided approximately $1 million in financial support, including through the ECA Grants Program, for the Public Interest Advocacy Centre (PIAC), the South Australian Council of Social Services (SACOSS) and the Consumer Utilities Advocacy Centre (CUAC) to engage in the LMR processes. In the case of PIAC, this funded a consumer application that challenged the level of revenues network businesses were permitted to recover under the Australian Energy Regulator (AER) determinations. In the case of SACOSS, the application (which failed) argued that the AER had not addressed comments by its own Consumer Challenge Panel that the AER should review the rapid increase in South Australian Power Network's (SAPN) operating expenses.

ECA have also given evidence in our own capacity to the Tribunal's Community Consultations in New South Wales and South Australia and will be doing so for Victoria. We have dedicated significant attention to evaluating the extent to which the new LMR regime is serving the long-term interests of residential and small business energy consumers.

Ensuring the energy market works for consumers must not be lost in the deliberations about the complex set of issues around the objectives and design of any review mechanism. The amount the average household spends on electricity has approximately doubled in the last ten years, placing pressure on all consumers, but particularly on those on low incomes or with vulnerabilities. The number of consumers that are being disconnected from their energy supply – over 150,000 in 2014/15 – has tracked these price increases and is of deep concern given the impact that being without these essential services has on households.

ECA also received feedback during our regional consultations that the price rises are also hitting the engine room of the Australian economy – small businesses – hard. Agribusiness that rely on pumped irrigation and food processors are feeling the effects particularly acutely.[1] In the community consultation one almond processor in South Australia reported that energy costs are threatening his export competitiveness, while a campaign group *Arc Up* has been established to demand an end to high electricity prices in regional Queensland.[2]

In this context it is worth grounding the review discussion in the facts of one of the LMR decisions now under appeal, the Ausgrid Determination:[3]

[1] See Tom Chesson, CEO National Irrigators Council, evidence to Australian Competition Tribunal's Community Consultation for the South Australian Power Networks (SAPN) appeal http://www.competitiontribunal.gov.au/documents/act2015/ACT11of2015-transcript.pdf

[2] http://www.northqueenslandregister.com.au/story/3847821/community-arcs-up-over-power-prices/

[3] AER fact sheet outlining final Ausgrid distribution determination https://www.aer.gov.au/system/files/AER%20-%20Final%20decision%20Ausgrid%20distribution%20determination%20-%20Fact%20sheet%20-%20April%202015_2.pdf

	AER	AUSGRID
TOTAL REVENUE	$6,576m	$9,754m
ROR	6.68%	8.85%
OPEX	$1,993m	$2,679m
CAPEX	$3,201m	$3,756m
EST. ANNUAL RESIDENTIAL PRICE REDUCTION	$165	
EST. ANNUAL SMALL BUSINESS PRICE REDUCTION	$264	

ECA's quantitative research backs up the view that consumers are not confident that the energy market – defined as the industry and the regulators – is working in their interests now, or is likely to do so in the future.[4] We also find evidence that the significant increases in the cost of energy that consumers have experienced in the last ten years has contributed to a situation where many people are considering taking, or have already taken, steps to reduce their dependence on the grid. While consumers are concerned about the environment, our survey indicates that the principal driver for the explosion in solar PV has been to manage their consumption and gain control over their costs. This represents a major volume risk for networks going forward that must figure in the way they approach the regulatory and review process.

Of course, this sentiment cannot be sheeted home solely to the functioning of the LMR regime, or indeed just to the performance of network businesses. Consumers are telling us that there are a range of issues around choice and the way the retail market is organised that is causing them to question whether they are getting value for money for their electricity and gas services. But it should cause all stakeholders to pause to reflect on how the decisions taken in relation to the review mechanisms will play out over the longer term, and either add to, or subtract from, trust and confidence in the regulatory framework. What is at stake was neatly summarized by the Expert Panel in its Stage Two Report:

> *The vital ingredient for stability, namely legitimacy, is fast being eroded under the current LMR arrangements, particularly on the part of consumers whose interests these arrangements are meant to serve. The Panel's view is without controlled adjustment now, in a way that we can be confident will comprehensively deal with the identified problems, the industry will increasingly face the likelihood of significant disturbances from ad hoc policy responses – a process that has already visibly started*

[4] See page 6, *ECA Energy Consumer Sentiment Survey*, July 2016 http://www.energyconsumersaustralia.com.au/documents/Energy-Consumer-Sentiment-Survey-Survey-Findings-National.pdf

– which will pose great risk to regulatory certainty and investor confidence in the medium and longer terms.

As the representations made to the Tribunal's Community Consultations show, the sense is that the regulatory and review process is disconnected from the interests of the very people it is meant to serve. This remains the case despite the legislative changes that were made in 2013 and will continue to be a source of the instability that the Expert Panel sought to address.

Assessing LMR against the policy intent of the 2013 reforms

The 2012 review of the LMR regime by the Expert Panel is the lens through which this latest review must be considered. As the Consultation Paper sets out, the Expert Panel identified two major problems with the LMR regime:

1. the tendency for the scope of reviews to be unduly narrow; and
2. insufficient attention to the LTIC in the National Electricity Objective (NEO) and the National Gas Objective (NGO).

The Expert Panel went on to call for a 'significant re-orientation of the review process', recommending, among other things, modifying the framework to:

- recognise that the 'ultimate end, and therefore the ultimate test, is the long-term interests of consumers';
- avoid the manifest economic error that promoting economic efficiency necessarily serves that purpose; and
- make the process *investigative* rather than *adversarial* in nature.

The subsequent legislative amendments in 2013 made a suite of changes to the LMR regime to give effect to this vision – notably to elevate the LTIC objective and to introduce the *materially preferable NEO/NGO decision as a whole* criterion to make the Tribunal's assessment more holistic. Four years on, the question is whether the LMR regime is delivering on this policy intent.

A high proportion of the AER's decisions continue to be subject to review as the networks test the new framework. While this does not, in and of itself, provide definitive evidence that the LMR regime is not working, it does at the very least give the appearance of LMR continuing to be seen by some as a routine, final step in the regulatory process.[5] That networks have been able to consistently win additional revenue from the Tribunal does not do anything to engender consumer confidence in the process. It also helps explains why the South Australian[6] and Victorian governments felt compelled to intervene on behalf of consumers in their states. At least on the face of it, one can see how Minister D'Ambrosio reached the conclusion that '*the*

[5] Note that some appellants have argued that problems remain with the AER decision making process.

[6] Media statement, The Hon. Tom Koutsantonis MP, Minister for Mineral Resources and Energy, 1 August 2016 http://www.premier.sa.gov.au/index.php/tom-koutsantonis-news-releases/934-state-government-to-intervene-in-attempts-by-sapn-to-charge-south-australians-more-for-electricity-distribution

current system is very complex and results in a lengthy and costly process, which ultimately disenfranchises and penalizes hard-working Victorian families'.[7]

In the recent round of appeals there is significant evidence that the new LMR regime is not operating as the policy makers intended.

Legalistic not investigative

As Minister D'Ambrosio has pointed out above, the Tribunal process remains highly legalistic and adversarial despite the 2013 reforms (dot point 3 above). All parties were represented by senior legal counsel in hearings where an almost unbelievable volume of information – approximately 1.3 million pages of material in the NSW and ACT appeals – was presented to the Tribunal.[8] This means in practice that consumers continue to be all but shut out of the process. This is despite significant funding from ECA as well as other advocates devoting a considerable amount of their own time and resources through co-contributions. This is not sustainable when the need for research and evidence-based advocacy to support consumers on a host of other issues in a changing market is so great.

It was hoped that community consultation would provide a way into the process for consumers. It is ECA's strong view, and this is one shared by many advocates, that Community Consultations undertaken by the Tribunal has not delivered on this promise. There is very little in the Ausgrid decision to indicate that the Tribunal engaged in any meaningful way with the representations it received through the Community Consultations. It is our view that the Tribunal was wrong to use PIAC's views, as a party to the appeal, as a proxy for the views of all consumers, given the diversity of views at the consultation.[9]

Uncertainty

The second problem is that with the Tribunal's decision to remit the NSW and ACT appeals back to the AER for resolution, and the AER's subsequent decision appeal to the Federal Court, we have a process without a clear end point. At worst, this could play out as an endless loop of appeals if the Federal Court finds in favour of the AER, refers the matter back to the Tribunal, which then makes its own referral to the AER, who then makes a decision that network businesses challenge. Even if the Federal Court upholds the Tribunal, the AER still has to remake the determination which is still a reviewable decision. Given the Tribunal did not reach a conclusion on all the matters listed as grounds the process of review with a decision to remit could continue.

It is worth noting that NSW matters are already prepared for Judicial Review should LMR proceeding resolve unsatisfactorily from the networks perspective.

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[7] Media statement, The Hon. Lily D'Ambrosio MP, Minister for Energy, Environment and Climate Change, 3 August 2016 http://www.premier.vic.gov.au/fighting-for-lower-electricity-prices/

[8] ABC Background Briefing, *The big disconnect*, 8 November 2015 http://www.abc.net.au/radionational/programs/backgroundbriefing/the-big-disconnect/6915554#transcript

[9] Australian Competition Tribunal, *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016], at paragraph 64 http://www.judgments.fedcourt.gov.au/judgments/Judgments/tribunals/acompt/2016/2016acompt0001#_Ref444071226

The problem from a consumer perspective in all of this is uncertainty about prices and the risk of bill shock should a network seek to recover revenue over a compressed timescale following the resolution of an appeal. As it has turned out, in NSW the networks have sought a rule change to in effect smooth the price path for consumers, but this is an unsatisfactory process in itself in terms of time and effort of all concerned.

The new test: materially preferable NEO/NGO as a whole

Given that we are concerned about the consequences of the Tribunal's decision to remit, ECA has sought to understand why the Tribunal made the decision to remit, and the way it went about applying the new materially preferable NEO decision criterion.[10]

Grounds

The first observation is that part of the logic for introducing the materially preferable NEO decision criterion in s 71C(1a) was to lift the threshold that applicants would need to meet to be granted leave to appeal. That is, applicants would be required to demonstrate, up front, how the Tribunal by correcting the error, incorrect exercise of discretion or unreasonableness by the AER, would lead to a materially preferable decision. In practice however, the Tribunal has allowed all grounds of appeal lodged by network businesses to be heard as part of the appeals. Although there was some debate about the breadth of the grounds of review during the application stage of the Ausgrid matter, the Tribunal reached the view that it was "*preferable to defer addressing that debate until the point of considering separately the particular issues which the various applicants raised, and how the asserted error was then described*"[11]. This deferral indicates to ECA that the new threshold is not acting as the higher threshold envisaged by the Expert Panel to *"mitigate against any tendencies for the review to become a de novo review of decisions in each and every case"*.[12]

Consumer access

While the Tribunal took one approach in relation to network business appeals, consumer advocates did face a higher hurdle with the Tribunal, as a result of the 2013 reforms. It is noteworthy that the South Australian Council of Social Services (SACOSS) was denied leave to appeal the South Australian Power Networks (SAPN) decision, and the Victorian Energy Consumers and Users Alliance (VECUA) opted not to appeal in Victoria on prospects advice about legal issues around the grounds of appeal.

The limited 15-day window parties have to apply for review following the publication of final determinations by the AER continues to place consumer advocates at a particular disadvantage when it comes to making out grounds of review. Without the network businesses early insight into the content of the final determination, or the extensive legal and technical resources needed to identify errors and develop a materially preferable alternative in tight timeframe, consumer advocates' ability to raise an appeal in their own right is severely

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[10] *National Electricity (South Australia) Act 1996* s 71C(1)(1a).
[11] Australian Competition Tribunal, *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016], at paragraph 103 http://www.judgments.fedcourt.gov.au/judgments/Judgments/tribunals/acompt/2016/2016acompt0001#_Ref444071226
[12] Yarrow, Egan and Tamblyn, *Review of the Limited Merits Review regime: Stage Two Report,* 2012, p 35 https://scer.govspace.gov.au/files/2012/10/Review-of-the-Limited-Merits-Review-Stage-Two-Report.pdf

constrained. While consumer advocates may be able to join a network business appeal later in the process as an intervenor, they will be limited to raising matters that fall within the scope of the network business application. It may also be the case that tight deadlines encourage network businesses to seek review.

Still correcting errors

It is not clear to ECA that the materially preferable NEO decision criterion, which also operates via s 71P(2a)(c) beyond the application stage in the appeal itself as a core test of whether ground of reviews should be upheld, has changed the way the Tribunal is approaching its task. Rather than explaining in detail how it satisfied itself that correcting the errors would deliver a materially preferable decision, the Tribunal appears to have relied on the view that, having established that the AER had made its decision on 'foundations that [were] not properly established', it followed that remitting it for correction would *necessarily* do so.[13] It is difficult to see how on this logic the correction of any error would fail the materially preferable test, leaving the door open for the networks' 'cherry-picking' which the 2013 amendments were designed to stop.

LTIC paramount in aligning interests of consumers and networks

Our analysis of the Ausgrid decision also causes us to doubt whether the Tribunal fully understood that the long term interests of consumers was its 'paramount' consideration under the new LMR regime.[14] The Tribunal found, for example that the inefficient costs of enterprise bargaining agreements (EBA) could be recovered from consumers because it was 'the policy of the legislative arm of government'.[15] In other parts of the decision, such as here at paragraph 466, the Tribunal sets up the LTIC as something to be weighed against network businesses interests:

> *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 one hand and the interests of DNSPs on the other.*

Or at paragraph 465, where the Tribunal also appears to compromise the LTIC, noting in regard to the AER:

> *"It must also have regard to the legitimate business interests of a DNSP and should not put itself in an adversarial position in relation to the DNSP so that it may be perceived as a champion of the consumers"*.

In view of our strong concerns, and interest in effective review mechanisms, ECA considered how it might participate in the AER's Federal Court appeal of the Tribunal's NSW and ACT

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[13] Australian Competition Tribunal, *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016], paragraphs 1200-1220. http://www.judgments.fedcourt.gov.au/judgments/Judgments/tribunals/acompt/2016/2016acompt0001#_Ref444071226

[14] https://scer.govspace.gov.au/files/2012/12/LMR-Statement-of-Policy-Intent-December-2012.pdf

[15] Australian Competition Tribunal, *Applications by Public Interest Advocacy Centre Ltd and Ausgrid* [2016], paragraph 436. http://www.judgments.fedcourt.gov.au/judgments/Judgments/tribunals/acompt/2016/2016acompt0001#_Ref444071226

decisions to raise these 'framework' questions. We received legal advice that we were not able to do so on the basis that the matters were outside the scope of the AER's appeal which solely sought clarity of the Tribunal's direction in the remitted decisions rather than the application of the new framework.

Considering the reform options

While it is clear to ECA that the LMR regime is not performing as intended, it may be premature to conclude that LMR cannot work. The reason for this view is the fact that the current round of appeals has not fully played out, and that the Tribunal affirmed the AER's original decision in relation to a number of grounds of review in the Ausgrid matter (indicating that review is not necessarily a one-way street). Like the Expert Panel, we are also very mindful that there is a legitimate role for LMR in promoting accountability of the regulator for the quality of their decision making and helping to drive continuous improvement in regulatory performance. Further, we also see examples in other jurisdictions internationally where retailers have used LMR regimes to challenge revenue determinations on behalf of their customers.[16] This would be a welcome development in the Australian context.

While the focus of the discussion about the performance of the post 2013 LMR regime has been the six appeals that have been made to the Tribunal, it is also important consider the revenue determinations in whole or in part that were not appealed, and why.

These provide some evidence that networks' decision-making when it comes to weighing up whether to launch appeals is changing. Australian Gas Networks (AGN), opted not to appeal despite a significant reduction in the allowed revenue in 2016-2020 Access Arrangement.[17] network businesses in Queensland were directed by the State Government not to appeal.[18] South Australian Power Networks (SAPN) narrowed its application for appeal, withdrawing its return on equity ground of appeal after the Tribunal found in favour of the AER on a number of matters in the NSW and ACT appeals.[19] And in the last network determinations, the Victorian networks elected to appeal decisions that impacted only between 3-7% of the revenue determination.

Options 1 and 3

Given the significant issues ECA has identified in the previous section, and the obvious "legitimacy deficit", we do not consider that maintaining the status quo, Option 1 in the consultation paper, is viable.

Further, ECA does not see how creating a new body to administer a review process would lead to better outcomes, given that it in our view it would encounter the same issues of

[16] See British Gas appeal of Ofgem's RIIO-ED1 decision https://www.gov.uk/cma-cases/energy-price-control-appeal-british-gas-trading.
[17] In real terms, AGN's total revenue for 2016-2021 was 20.1 per cent less than the amount approved for 2011-16. See p 10 of the AER's overview of the final decision http://tinyurl.com/jgftplu
[18] http://statements.qld.gov.au/Statement/2015/10/29/power-price-stability-locked-in-for-queenslanders
[19] Australian Competition Tribunal, http://www.competitiontribunal.gov.au/current-matters/community-consultations/act-11-of-2015/explanatory-memorandum

complexity that the Tribunal faces. In any case, to provide a new body with the significant extra resources it might need to allow it to, for example, undertake its own comprehensive assessment against the materially preferable NEO criterion, would in effect be to create a duplicate economic regulator that could undermine the authority of the AER. That said, there are things that could be done to restructure the Tribunal to make it less adversarial and more investigative. We explore these in the section on option 2 below.

These considerations lead ECA to the view that the solution may lie in some combination of options 2 and 4 in the consultation paper. Our objective would be to deliver the right level of accountability through review mechanisms, but create a powerful set of incentives for network businesses to engage with the AER and consumers up front. We say some combination, because it seems to us that the AER performs two distinct tasks in making network revenue determinations that require different types of review. The first task is to reach a view about a particular network's efficient level of operating and capital costs, that may vary case by case from network to network. On the other hand, the second task is to devise and apply a common set of financial guidelines (i.e. the WACC, gamma, efficiency benchmarking where a network business is compared to an empirically estimated frontier) that apply to all networks.

General principles for review

Whether LMR or judicial review is the review option available, some general principles can be considered in either case.

The first is the benefits that would accrue from making "constituent decisions" binding. The most obvious example is the Rate of Return Guideline where the same issues apply to all networks – and have resulted in the same appeals (e.g. gamma). Currently if the Rate of Return Guideline were to be made binding it would only be subject to judicial review. There is the option to create a new element to the regime called a "reviewable decision" that can be binding for subsequent determinations but in itself is subject to LMR.

The second is the benefit that would accrue from aligning the determination processes so that it is easier to assess the comparative efficiency of the network businesses, and to give all stakeholders an opportunity to take stock of experience and regulatory developments within one period. The staggered and constant stream of revenue determinations, sequentially, under the current arrangements allows no time for comparative reflection and learning and in ECA's view is one of the root causes of the issues that are manifesting at the LMR review stage.

ECA in the discussion below identifies how a modified LMR and/or reliance on judicial review could promote the long-term interests of consumers.

Option 2: Limited Merits Review

It is ECA's view that it may be appropriate to retain recourse to LMR wherever there is a high degree of discretion exercised by the regulator. An example is the assessment and decision-making in relation to operating and capital expenditure. Because there is an information asymmetry that exists between the AER and network businesses significant judgement is needed to determine cost pathways over time in a dynamic market.

There is considerable scope to reduce this asymmetry – and the incidence of appeals – through the continued development of benchmarking techniques and stronger incentives for network businesses to submit more accurate cost estimates.[20]

For those cases where a decision is appealed, there are a number of changes that could be made to the LMR regime to address the problems we have identified in this submission.

Limited

Leaving 'error 'as a grounds of review in s 71C(1)(a) of the National Electricity Law has obscured the new policy focus on the decision as a whole that the insertion of the materially preferable decision criterion in s 71C(1a) was intended to deliver. What was meant to become a two-stage test has been collapsed into one that is really just about identifying an error. We see this, for example, in United Energy Distribution (UED) application for review of its 2016-2020 Revenue Determination:

> *The perpetuation of error is itself a matter that impairs "regulatory certainty", and thus the correction of error is itself conducive to the achievement of the NEO'.*[21]

ECA believes that consideration be given to removing the error element of the test in s 71(C)(1), to ensure that the focus is where it should be, and that is on the exercise of discretion, and the reasonableness of the regulator, in achieving the LTIC.

ECA believes that there is considerable scope to streamline the Tribunal's process. Determining that all the material submitted to the AER is evidence and brought in to any electronic case management system will reduce the resubmission of the same document multiple times as occurred in the NSW proceedings.[22] Similarly legislating that the "cut-off date" for matters that can be considered by the tribunal is only material received by the AER before a submission close date, or by agreement by the AER. This will restrict the current gaming of network businesses submitting material just before the determination is made for the purposes of appeal. This needs to be matched by the AER publishing its own consultants' reports in time for comments to be received on them.

Merits

The structure of the Tribunal itself – currently a Federal Court judge supported by two lay members with technical expertise – might be adapted to reduce the extent to which the

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[20] This might include what are colloquially known as 'truth-telling' incentives such as those used by Ofgem in the UK – the IQI incentive, discussed in the RIIO Handbook (p 66) here being a good example https://www.ofgem.gov.uk/ofgem-publications/51871/riiohandbook.pdf

[21] http://www.competitiontribunal.gov.au/__data/assets/pdf_file/0005/31919/ACT-3-of-2016-Application-for-Leave-and-Application-for-Review.pdf paragraph 107(g).

[22] Imposing strict limits around the volume and nature of the material that can be tendered as evidence is an approach the Competition and Markets Authority in the United Kingdom has recently adopted to allow it to more efficiently progress appeals – see process outlined in this guideline https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284450/cc14.pdf in the appeals by British Gas and Northern Powergrid in 2015 – see discussion at paragraph 3.63 of the CMA's final determination https://assets.publishing.service.gov.uk/media/5609588440f0b6036a00001f/BGT_final_determination.pdf

process plays out as a highly adversarial contest between the parties. Changes to the format should also be considered: the 'hot tub' method that has been used in the Federal Court and in other jurisdictions may be a better way of reconciling differences on complex technical matters than traditional means of hearing evidence.[23] This goes directly to the intent of the Expert Panel that processes should be more investigative rather than adversarial.

Review – putative LTIC alternative

In the spirit of the Expert Panel's deliberations, it is ECA's view that rather than significantly increasing the Tribunal's resources to give it the capability to undertake the complex task of evaluating the overall decision so that it could propose an alternative rather than default to remit, the onus could be placed on the appellant to develop a putative alternative decision. This would put the Tribunal in a position where it is choosing between two fully developed alternatives, rather than the situation it currently faces where it is comparing the AER's original decision against a hypothetical where certain errors have been corrected, and any other adjustments made to ensure it is materially preferable 'as a whole'.

In this construction the Tribunal process may be changed to a 'final offer arbitration' model, where the prospect of the Tribunal making a more binary choice between two alternatives creates an incentive for the AER and the network businesses to reach a negotiated settlement. It is noteworthy that price certainty proposed by networks over the period that is the subject of the NSW and ACT appeals in the Federal Court was achieved by negotiation.[24]

If the Tribunal were to be left with the ability to remit the decision at first instance a process needs to be specified for concluding the process. ECA's suggestion is that a new "propose-respond" round be conducted with very limited timelines – something like two weeks for the network businesses and two weeks for the AER, and if the network businesses does not agree to the AER a final review by the Tribunal would be on a final offer basis.

Materially preferable NEO as a whole formulation

There may also be a need to go a step further and re-formulate the materially preferable NEO decision test to lift the threshold for review as the policy makers intended and in effect, to give more deference to the AER. Stating the test in the negative, for example, might better guard against error correction and cherry picking: '*is the AER's decision unreasonable in the context of materially compromising the delivery of the long term interests of consumers as set out in the NEO and NGO?'*.

It may also be desirable to provide some greater clarity around materially preferable. Guidance can include that something doesn't materially compromise the LTIC if the network can "cut its cloth" to match the revenue (e.g. by deciding not to do some discretionary work), or that it could recover the difference in a future regulatory period (e.g. by deferring an investment).

Finally, if LMR is retained for any aspect of revenue determinations, or introduced for constituent decisions, then the Administrative Decisions Judicial Review Act should be

[23] Federal Court judge Steven Rares explores hot tubbing in this paper here http://www.fedcourt.gov.au/publications/judges-speeches/justice-rares/rares-j-20131012

[24] https://www.aer.gov.au/news-release/aer-finalises-network-charges-in-the-act-and-nsw-from-1-july-2016

amended to include any item as being available for Merits Review as not being also available for judicial review at first instance by including determinations by the AER in the list of items exempt from judicial review in Schedule 1 of the ADJR Act. While it would still be possible to seek judicial review of a Tribunal decision, limiting the avenues of review available to network businesses and other interests in relation to AER decisions would help mitigate the risk of 'forum shopping' and the extra cost, complexity and time associated with this kind of strategic behaviour. For instance, the NSW networks were prepared to fall back on judicial review had they failed in their application for limited merits review. There's a real risk therefore that lifting the threshold test for merits review without the reform of the kind we suggest here could simply move the problem upstream, as appellants shift their focus to judicial review.

Option 4: Judicial Review

As discussed with reference to Option 3, ECA believes the AER and the network businesses could develop, with appropriate consumer engagement, a set of binding financial guidelines that would apply uniformly to all network businesses. The parameters in these guidelines are likely to vary over time, but should not otherwise vary by network (other than allowing for some risk premium for one network over another in its financial risk).

This kind of approach has met with some success in New Zealand, where 'input methodologies' are developed and used in this way, and are subject to merits review. If such a process was to be applied in Australia it could be undertaken as a rigorous and open process up front, in which the AER undertakes the mechanistic task of applying WACC, gamma and other settings in an agreed guideline to each revenue determination. In which case, ECA considers that it could be appropriate to rely solely on judicial review to provide the necessary check on these quality of these decisions rather than having them open to review on the merits. This approach would preserve the authority of the AER by lifting the hurdle for review: applications for review would need to demonstrate that no reasonable regulator would have made the decision. It may also allow consumer advocates to engage more fully on those particular matters that vary by network, and by consumer preferences, in a much more efficient and strategic way than is currently the case, where their time and resource is spread across all elements of the building block approach for each of the individual network businesses revenue determinations.

If the Energy Council did decide to rely more heavily on judicial review – either in relation to the financial aspects of revenue determinations, or as the sole review mechanism for all aspects of the revenue determination as per option 4 – special arrangements would need to be made to allow consumers to participate. Without cost protection and adequate funding to provide opportunities for consumers to be legally represented in this process, it is very unlikely that any consumer advocate including ECA would be able to raise or join an appeal, no matter how strong their case. ECA also has a real concern around standing, given our own experience where legal prospects advice indicated that we would not be granted leave to join the AER's Federal Court appeal of the Tribunal's NSW and ACT decisions. ECA was advised that because the 'framework questions' around the Tribunal's consideration of the LMR reforms we wanted to pursue did not fall within the scope of the AER appeal, we could not participate in the judicial review. This narrow focus in judicial review on whether a decision is lawfully made, rather than whether it is consistent with the long term interests of consumers, does inevitably mean that we would be relying more heavily on the AER to get things right.

ECA's view is that automatic standing, even if this is just to allow consumers to join any appeal raised by a network business, the AER or another party, and not to be confined to their grounds of review, may be appropriate. Of course this would not be a right that consumers would routinely exercise given the costs, but what it would do is change the risk profile of any party contemplating judicial review, given it may expose them to an adverse finding on some other aspect of the decision.

ECA has been advised that proposals to give consumer advocates standing at judicial review have been resisted in the past. The Energy Council should not proceed down this path without a commitment that the Government, through the Federal Attorney-General would introduce the legislation. Amendment to the National Electricity Law in the South Australian Parliament should not be introduced until such Federal legislation has passed, or be made contingent upon such law being passed.

Future concerns

Importantly, in ECA's view, these deliberations about the review framework for network businesses revenue determinations must take account of broader policy and market developments.

While Australia has now signed up to binding international emissions reductions targets, the policy and planning to make the transition is yet to be settled. Decisions about the fuel mix, the deployment of renewables, and the integration of battery and other 'smart' technology into the grid, will have implications for the role and configuration of energy networks.

The work being undertaken by the AEMC and AEMO under the Energy Council's Energy Market Transformation Program will help lay the groundwork for this plan which should begin to emerge in 2017 as part of the Federal Government's review of emissions reduction policies.[25] It may therefore be that we are making a set of changes now, including to review mechanisms, that will be followed by more substantial changes towards the end of the decade.

One issue that is alive now though is whether the NEO/NGO needs to be amended to provide an explicit link between emissions policies and the regulatory framework. ECA's view is that that the LTIC should remain the paramount objective of the regulatory framework, to ensure that the costs associated with the transformation are managed and that consumers pay no more than is necessary. An alternative option that the Energy Council might consider as part of this review would be to make provision for the Federal Minister, representing the Energy Council, to issue a Ministerial Direction (as a Disallowable Instrument) setting out the strategic priorities for the transformation of the energy market. This is akin to the Social and Environmental Guidance that has been a feature of the United Kingdom's regulatory framework since 2000.

[25] See COAG Energy Council Energy Market Transformation overview here http://www.scer.gov.au/current-projects/energy-market-transformation. The terms of reference for the AEMC's new annual review of network regulation were released on 8 September 2016 and are available here http://www.aemc.gov.au/News-Center/What-s-New/Announcements/Terms-of-reference-published-for-new-annual-monito

Conclusion

ECA appreciates the opportunity to make this submission. Unfortunately, it has not been possible, given the tight timeframe for review, to have reached a definitive landing on measures that might be taken to address the failure of the review process to deliver the policy intent behind the changes that were made in 2013. ECA has reflected on our experience and proposed ways forward so as to contribute positively to the work of the review. We look forward to further engaging with the Energy Council and stakeholders on particular solutions as they emerge, that best address the long term interests of consumers.

Please do not hesitate to contact Chris Alexander, Director of Advocacy and Communications, if you would like to discuss or require further information.

Energy Consumers Australia

ABN: 96 603 931 326

Suite 2, Level 14, 1 Castlereagh Street
Sydney NSW 2000

02 9220 5500
@eca_advocacy
energyconsumersaustralia.com.au