Chapter 2

Issues raised in evidence

2.1 This chapter examines the evidence provided in submissions to the inquiry, and considers the key issues raised by stakeholders.

Evidence in support of abolishing limited merits review

2.2 Submitters who supported the abolition of limited merits review commented that the regime had failed to meet its policy intent; failed to serve the long-term interests of consumers; is open to gaming by network businesses; is highly legalistic, costly and complex; has introduced uncertainty; and undermined the regulatory process. Energy Consumers Australia (ECA), for example, stated that it hoped that the abolition of limited merits review 'will signal the end of what we think has been a very costly and counterproductive period in network regulation'.[1] The Public Interest Advocacy Centre (PIAC) stated that the bill 'should be passed without hesitation'.[2]

Failure to meet the policy intent

2.3 The Department of the Environment and Energy (the department) emphasised that the original policy intent of the limited merits review regime was that it 'would be a limited form of review that only resulted in the regulator's decisions being overturned where there was a materially better outcome for consumers, in the long-term interest of consumers'.[3] However, submitters supporting the abolition of limited merits review noted that review of the Australian Energy Regulator's (AER) decisions had become a routine part of the regulatory process and, rather than reducing pressure on energy prices, consumers have experienced increased costs as a result of limited merits review.

2.4 Submitters also pointed to the reviews of the limited merits review regime conducted in 2012 and 2016 and noted that significant shortcomings were identified. In addition, while reforms were introduced following the 2012 review, the 2016 review concluded that these had been unsuccessful and stakeholders and the COAG Energy Council continued to have concerns about how the regime was operating.[4]

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1 Mr Chris Alexander, Energy Consumers Australia, *Committee Hansard*, 3 October 2017, p. 34.

2 Mr Craig Memery, Public Interest Advocacy Centre, *Committee Hansard*, 3 October 2017, p. 24.

3 Ms Joann Wilkie, Department of the Environment and Energy, *Committee Hansard*, 3 October 2017, p. 29.

4 Ms Joann Wilkie, Department of the Environment and Energy, *Committee Hansard*, 3 October 2017, p. 29.

2.5 The department also commented that limited merits review is not delivering outcomes which are in the long-term interests of consumers. Ms Joann Wilkie explained the department's position as follows:

> Rather than actually reducing regulatory and price uncertainty, it's contributed to greater regulatory and price uncertainty. It's basically created significant costs for all stakeholders. We don't believe there's actually been a measurable benefit to counter that.[5]

2.6 It was argued that limited merits review has become a routine part of the regulatory process. The department commented that two-thirds of the AER's decisions have been appealed and all appeals had been instigated by network businesses.[6] Mr Chris Pattas, AER, provided an explanation for this outcome and stated that:

> The limited merits review process provides an avenue to networks for more revenue and higher prices without any downside risk, whilst giving consumers very little voice in the matters.[7]

2.7 While supporting the retention of a reformed limited merits review regime, Mr Paul Italiano, Chief Executive Officer, TransGrid, commented that using limited merits review 'to full commercial advantage where perhaps there isn't a clear consumer benefit is a possibility'. Mr Italiano went on to stated that:

> The way the LMR [limited merits review] is configured at the moment does allow networks to do that. In theory, the [Australian Competition Tribunal] has to make a decision as to whether or not it is in the consumer interest. The network doesn't have to establish that clearly enough before they make the appeal, so that's open to manipulation or use by someone.[8]

2.8 The AER commented on reform of limited merits review and stated that 'our view is that further attempts at reform are likely to be unsuccessful, and that's because of the fundamental nature of the limited merits review framework'.[9] The department also commented that:

> …one of the things that we came back to was that the financial incentives for appeals are just so great that it is very difficult to design a regime in

5 Dr Joanne Bright, Department of the Environment and Energy, *Committee Hansard*, 3 October 2017, p. 32.

6 Ms Joann Wilkie, Department of the Environment and Energy, *Committee Hansard*, 3 October 2017, p. 32.

7 Mr Chris Pattas, Australian Energy Regulator, *Committee Hansard*, 3 October 2017, p. 37.

8 Mr Paul Italiano, Chief Executive Officer, TransGrid, *Committee Hansard*, 3 October 2017, p. 22.

9 Mr Warwick Anderson, Australian Energy Regulator, *Committee Hansard*, 3 October 2017, p. 37.

> which you're not going to see what we've seen come out of this, which is, effectively, appeals being a routine part of the regulatory process.[10]

2.9 Price increases arising from limited merits review were a major concern for both the Government and stakeholders. The AER reported that in over thirty appeals, network revenues have experienced increases, in all but one instance.[11] Further, it has resulted in outcomes which have been 'consistently detrimental to consumers' with 'very little practical downside to service providers seeking merits review'.[12]

2.10 The AER illustrated the failure of limited merits review to meet policy intentions by noting that:

- appeals from 2008 to 2013 resulted in revenue increases of approximately $3.5 billion (nominal); and
- since 2014, networks have sought appeals totalling approximately $7.2 billion (nominal). The final outcomes of these reviews have not yet been finalised.[13]

2.11 Similarly, Mr Craig Memery, PIAC, commented on the lack of limited merits review determinations which resulted in the reduction of costs:

> Removing LMR will clearly make it harder for businesses to cherry-pick those aspects of the regulator's decision in a manner that results in those mounting costs for consumers.[14]

2.12 Similarly, the ECA noted continuing price increases and stated that 'in the last ten years electricity prices have doubled, with network costs being the single biggest contributor'.[15]

2.13 The department concluded that the abolition of limited merits review will 'alleviate energy price pressures faced by consumers by empowering the regulator to prevent unnecessary growth in the network component of their energy bills'.[16]

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10 Dr Bright, Department of the Environment and Energy, *Committee Hansard*, 3 October 2017, p. 31.

11 Australian Energy Regulator, *Submission 3*, p. 2.

12 Australian Energy Regulator, *Submission 3*, Attachment 2, Submission to the review of limited merits review framework, October 2016, p. 15.

13 Australian Energy Regulator, *Submission 3*, p. 1.

14 Mr Craig Memery, Public Interest Advocacy Centre, *Committee Hansard*, 3 October 2017, p. 25.

15 Energy Consumers Australia, *Submission 12*, p. 1.

16 Ms Joann Wilkie, Department of the Environment and Energy, *Committee Hansard*, 3 October 2017, p. 30.

The AER also commented on its recent experience of recent experience of cascading reviews and stated that:

> …due to the long and complex review processes, we are commonly forced to make decisions where previous appeals are outstanding and we do not yet have access to the outcomes of the appeal process. This creates significant uncertainty and has contributed to divergent outcomes on substantially similar decisions.[17]

Compromise of the regulatory process

2.14 Another issue raised in submissions, and in evidence from witnesses supporting the bill, was that the current review regime was compromising the initial regulatory decision making process.[18]

2.15 The AER highlighted this problem with reference to its appeal to the Full Federal Court in 2016, regarding the Australian Competition Tribunal's (the Tribunal) review its determinations for several energy companies. The AER commented that the outcome the decision in the appeal was that limited merits review allows the Tribunal 'broad scope in the decision making process, despite the legislative limitations implemented by the COAG Energy Council in 2013'.[19]

2.16 The AER submitted that this finding reinforced the COAG Energy Council's conclusion of the limited merits review regime's shortcomings, particularly in relation to:

- the Tribunal as a second regulator without adequate resourcing to undertake the complex tasks involved in proper network regulation;
- the potential for limited merits review becoming the focus of the primary decision making process; and
- the compromising of the AER's engagement with service providers and the exclusion of any input from consumers.[20]

2.17 A number of submitters supported the view that the Tribunal had become the second regulator and that limited merits review had become the focus of decision making. PIAC commented that 'the primary focus of the whole review process is as an

17 Australian Energy Regulator, *Submission 3*, p. 2.

18 Australian Energy Regulator, *Submission 3*, pp. 1–2; Dr Bruce Mountain, CME Australia, *Committee Hansard*, 3 October 2017, pp. 8–10; Department of the Environment and Energy, *Committee Hansard*, 3 October 2017, pp. 29–31; Mr Chris Pattas, Australian Energy Regulator, *Committee Hansard*, 3 October 2017, p. 37.

19 Australian Energy Regulator, *Submission 3*, p. 3.

20 Australian Energy Regulator, *Submission 3*, p. 3.

endgame in the regulatory process, rather than a last resort to hold the regulator to account when, and only when, they actually make a material error'.[21]

2.18 As a consequence, a range of adverse outcomes were identified. One such outcome is that the initial decision making process is compromised.[22] For example, Dr Bruce Mountain stated having to justify its decisions to the Tribunal:

> …stops [the AER] from making decisions in the round, looking at the economic incentives, which often isn't approval one way or the other but asks the regulator to consider the incentives of the entity that it's regulating. When it has a merits review appeal hanging over it, its own ability to step back and stay on balance is undermined.[23]

2.19 The AER also commented that review has become a' primary focus of the decision as opposed to the primary decision-maker focus'. It added:

> We don't think this supports the best initial decision. It tends to incentivise businesses or networks to be strategic in the timing and the scope of information they provide, and it fosters a guarded and adversarial relationship between the regulator and network providers. We don't think that promotes good outcomes, and we don't think that's in the long-term interests of end users.[24]

2.20 Submitters also noted that other issues arise with the Tribunal acting as the second regulator. These include that it does not have the same resources or time to come to decisions as the AER; network businesses have an incentive to submit material in a form that is highly legalistic and stakeholders require costly legal representation to engage in limited merits review.

2.21 In relation to Tribunal processes, Ms Julia Mansour, PIAC, noted the extensive public inquiry processes undertaken by the AER before a decision is reached which cannot be replicated by the Tribunal. Ms Mansour concluded that:

> …it's always going to be very difficult for the AER to come to a decision that keeps all of the different stakeholders happy, and that's not what it's supposed to do under its mandate. No doubt, there will be decisions that consumers and unions don't agree with. We all have an extensive opportunity throughout the regulatory process to put those views to the regulator and to make those points.[25]

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21 Mr Craig Memery, PIAC, *Committee Hansard*, 3 October 2017, p. 25.

22 Australian Energy Regulator, *Submission 3*, pp. 1–2; Mr Warwick Anderson, Australian Energy Regulator, *Committee Hansard*, 3 October 2017, pp. 37–38.

23 Dr Bruce Mountain, *Committee Hansard*, 3 October 2017, p. 9.

24 Mr Chris Pattas, Australian Energy Regulator, *Committee Hansard*, 3 October 2017, p. 37.

25 Ms Julia Mansour, PIAC, *Committee Hansard*, 3 October 2017, p. 27.

2.22 The ECA concurred with this view, and added that the regulator is required to exercise judgement and discretion as opposed to the legalistic and adversarial nature of the limited merits review regime, through which networks have been able to 'cherry-pick errors and extract revenue'.[26]

2.23 The extended period of time for consultation and engagement during AER determinations was emphasised. The Explanatory Memorandum outlined the comprehensive process through which the AER develops its revenue and access determinations, including its extensive inquiry processes, analysis, and consultations with stakeholders, that can take two and a half years or 32 months.[27] The department commented that this 'involves multiple opportunities for businesses, unions, consumer groups and other stakeholders to bring their views forward'.[28]

2.24 When exercising its economic regulatory functions, the AER is required, amongst other things to:

- act in a manner that is consistent with the NGO and NEO—including choosing between two or more possible decisions that will best contribute to the relevant objective;
- take into account the revenue and pricing principles when making a decision on a determination;
- undertake extensive consultation processes with all affected stakeholders—the AER ensures that when making a distribution or transmission determination in electricity, or an access arrangement decision in gas, that stakeholders are informed of the issues under consideration and given the opportunity to make submissions before a decision is made;
- publish draft decisions for public comment before a final decision is made; and
- provide reasons for the regulator's decisions including how the constituent components of the decision are related to each other and the manner in which that interrelationship has been taken into account in the decision making process.[29]

2.25 The AER also indicated that, in a regulatory determination process, 'stakeholders have at least two opportunities to express their views about the proposal,

26 Mr Chris Alexander, Energy Consumers Australia, *Committee Hansard*, 3 October 2017, p. 34.

27 Explanatory Memorandum, p. 5.

28 Ms Joann Wilkie, Department of the Environment and Energy, *Committee Hansard*, 3 October 2017, p. 30.

29 Australian Energy Regulator, *Submission 3*, Attachment 2, Submission to the review of limited merits review framework, October 2016, pp. 3–4.

to engage with the AER and other stakeholders, and to inform the AER's position on various issues'.[30]

2.26 The department concluded that the Tribunal is:

> …never actually going to be able to replicate effectively what the regulator does and what the stakeholders have opportunities to engage in in the first instance. What we've seen is that the limited merits review process has essentially disempowered the regulator by setting up the tribunal as an almost proxy second regulator. That undermines the primary decision process and the incentive for all stakeholders to engage effectively and constructively in achieving the best decisions from that.[31]

2.27 The complexity and high cost of engaging in limited merits review was highlighted with PIAC commenting that this worked to exclude consumers groups and other stakeholders in engaging in the process. PIAC stated that in the New South Wales limited merits review proceedings, Networks NSW alone paid legal costs in the vicinity of $90 million, which is about eight per cent of its net profit in 2014–15. In comparison, PIAC and Energy Consumers Australia spend about $500,000 to fund their involvement in both limited merits review and judicial review.[32]

2.28 The AER illustrated the legalistic and adversarial nature of the limited merits review by pointing to the thousands of documents involved in the Tribunal process and reported that AER officers have been told by network businesses that the regulator was not their audience, and that material was prepared for the Tribunal.[33]

Improved stakeholder participation

2.29 Some submitters commented that abolishing the limited merits review regime would limit the engagement of stakeholders, including consumers and workers in decisions that directly affected their interests.[34] In response to these concerns, the department emphasised that the lengthy primary decision making process provided stakeholders with sufficient input and robust oversight of the regulator's decisions.

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30 Australian Energy Regulator, *Submission 3*, Attachment 2, Submission to the review of limited merits review framework, October 2016, p. 7. See also Mr Craig Memery, Public Interest Advocacy Centre, *Committee Hansard*, 3 October 2017, p. 28.

31 Dr Joanne Bright, Department of the Environment and Energy, *Committee Hansard*, 3 October 2017, p. 31.

32 Mr Craig Memery, PIAC, *Committee Hansard*, 3 October 2017, p. 25. See also Mr Oliver Derum, Energy Consumers Australia, *Committee Hansard*, 3 October 2017, p. 35.

33 Mr Warwick Anderson, Australian Energy Regulator, *Committee Hansard*, 3 October 2017, p. 38.

34 Infrastructure Partnerships Australia, *Submission 9*, p. 2; Australian Council of Trade Unions, *Submission 4*, p. 3.

The department went on to comment that 'the very best place consumers can engage is in the regulator's primary decision process'.[35]

2.30 The department added that the COAG Energy Council has also recognised the need to improve the effectiveness of consumer engagement in AER decisions, particularly at the early stage of the process. The COAG Energy Council has agreed to reforms that will see the AER give a single, enhanced industry-wide process to set a rate of return element for businesses' revenue allowance. This will allow consumers to better target their resources and engage in the process at that early stage.[36]

2.31 On 5 October 2017, the Senior Committee of Officials of the COAG Energy Council released a consultation paper seeking feedback on how to improve consumer groups' resources and to address any barriers limiting their participation in the AER's primary decision process. The consultation paper stated:

> How consumers are resourced for these processes include but goes beyond funding. Other ways consumers groups can be resourced to support more effective engagement include capacity building, the structure of engagement processes, such as those that integrate explanation and training on complex issues, as well as other non-financial means of improving consumer engagement in revenue determination and access arrangement decisions.[37]

2.32 The AER also commented on stakeholder engagement. The AER stated that since the commencement of the COAG review of limited merits review it had 'observed perceptible and positive changes in the engagement between some networks and their consumers and the AER'.[38]

2.33 In addition, the AER went on to note that only one appeal had been lodged in relation to the three decisions released in 2017 and that appeal was ultimately dropped before it proceeded to a hearing. The trend has continued since the Minister's announcement on 20 July 2017 that the Government intended to remove access to limited merits review. The AER concluded that:

> In general terms, we have observed a growing acceptance that, with restricted or removed access to limited merits review, the primary decision process regains primary significance. In our view, this has contributed to

35 Dr Joanne Bright, Department of the Environment and Energy, *Committee Hansard*, 3 October 2017, p. 31.

36 Dr Joanne Bright, Department of the Environment and Energy, *Committee Hansard*, 3 October 2017, p. 30.

37 COAG Energy Council, *Consumer participation in revenue determinations and associated regulatory processes: Consultation paper on consumer resourcing*, 5 October 2017, p. 4. See also Dr Joanne Bright, Department of the Environment and Energy, *Committee Hansard*, 3 October 2017, p. 31.

38 Australian Energy Regulator, *Submission 3*, p. 6. See also Mr Chris Pattas, Australian Energy Regulator, *Committee Hansard*, 3 October 2017, pp. 37, 40.

> improvements in the way networks engage consumers and ourselves. This is consistent with our view that the availability of the Australian Competition Tribunal as a second and ultimate regulator has fundamentally affected the regulatory process.[39]

2.34 Energy Networks Australia (ENA) also confirmed that engagement with stakeholders was increasing. It noted that the ENA, ECA and the AER are working toward greater engagement between customers and businesses enabling a less adversarial decision making process.[40] The AER commented that this joint initiative will 'explore ways of improving sector engagement, and identify opportunities for regulatory innovation'.[41]

2.35 The ECA provided an example of this improved engagement and stated that networks have established their own stakeholder/customer consultative committee. Mr Chris Alexander, ECA, observed:

> They're engaging at a much higher level about what the consumer's priorities are and what investment and ongoing maintenance of the grid might need to happen over the next revenue period to make sure that those interests are aligned. Through those processes we're getting a much richer conversation and dialogue between the groups about what actually needs to be done. That's a dialogue where the consumers are able to make a much stronger point about issues like affordability. That process is starting to deliver some much better results.[42]

2.36 PIAC also noted the importance of engagement with consumers including engagement of consumers with businesses 'so that the submissions made to the regulator in the first place actually reflect, as best they can, consumer preferences and consumer views'.[43]

Evidence in support of retaining limited merits review

2.37 Opponents of the bill raised a range of concerns, including the lack of COAG endorsement, the need to address regulatory errors, impact on employees, the impact on network investment, the removal of stakeholders' participation, and the detrimental impact on the long-term interests of consumers.

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39 Australian Energy Regulator, *Submission 3*, p. 6.

40 Mr Garth Crawford, Energy Networks Australia, *Committee Hansard*, 3 October 2017, p. 15.

41 Australian Energy Regulator, *Statement of Intent 2017–18*, p. 3.

42 Mr Chris Alexander, Energy Consumers Australia, 3 October 2017, pp. 35–36.

43 Mr Craig Memery, PIAC, *Committee Hansard*, 3 October 2017, p. 25.

Lack of COAG endorsement and implementation before completion of the review process

2.38 A number of submitters expressed their concerns about the Commonwealth's unilateral action to abolish the regime without COAG's endorsement and before the completion of the review currently underway.[44]

2.39 It was argued that the Commonwealth's decision circumvented the COAG Energy Council, and is outside the governance arrangements for the national energy market under the AEMA. It was noted that the unilateral action contravenes clause 6.7 of the AEMA, which states:

> A party will not take any action that would limit, vary or alter the effect, scope or operation of the Australian Energy Market Legislation without the agreement of the MCE [Ministerial Council on Energy, now COAG Energy Council].[45]

2.40 It was argued that the Commonwealth's action undermines the principles of good governance and sound regulatory processes.[46]

2.41 A number of submitters observed that the bill ignored the review of limited merits review currently being undertaken.[47] Mr Lance McCallum, Australian Council of Trade Unions, commented:

> We are concerned that the work of the COAG Energy Council in relation to limited merits review seems to have been set aside without running its full course. We believe that the most sensible and practical action from this point forward is for the COAG Energy Council to be given time to finalise its position in relation to reform of the limited merits review regime after properly taking into consideration the feedback received during its consultations. This would be consistent not only with the decision of the December 2016 COAG Energy Council meeting but also with the principles of due process and proper reform.[48]

2.42 Several submitters, while supporting the retention of limited merits review, acknowledged that the regime was in need of reform to address flaws in the process

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44 Electrical Trades Union, *Submission 1*, pp. 2–3; Australian Council of Trade Unions, *Submission 4*, pp. 2–3; Energy Networks Australia, *Submission 5*, p. 2; Spark Infrastructure, *Submission 7*, p. 1.

45 Energy Networks Australia, *Submission 5*, p. 3.

46 Energy Networks Australia, *Submission 5*, p. 2; Spark Infrastructure, *Submission 7*, p. 1.

47 Queensland Law Society, *Submission 11*, p. 2.

48 Mr Lance McCallum, Australian Council of Trade Unions, *Committee Hansard*, 3 October 2017, p. 2.

and to ensure that long-term interests of consumers are served.[49] Mr Italiano, TransGrid, stated that limited merits review 'was good governance for Australia' although he acknowledged that:

> …there are elements of LMR that provide an opportunity for networks to take advantage of the economic appeal elements of it and perhaps exploit that to their commercial advantage.[50]

2.43 TransGrid therefore supported reform, rather than abolition, of limited merits review.

2.44 Other submitters provided examples of specific reforms to improve the limited merits review regime. Frontier Economics, for example, proposed reforms including a more investigative and collaborative (rather than adversarial) approach by the AER to making its decisions and enhancing the investigative powers of the Tribunal.[51]

2.45 The ENA also suggested improvements including introducing a single, binding and reviewable rate of return determination and a doubling of the financial thresholds for appeal, and these thresholds applying to each ground of review.[52] Mr Dillon from the ENA noted the rate of return was a significant issue included in most appeals. He went on to suggest that moving to a single binding guideline, that was only appealable once, 'would be crossing out up to three-quarters of the appeals'.[53]

2.46 However, Dr Mountain questioned whether the COAG Energy Council could agree on an adequate limited merits review regime to meet the policy intent and support the authority of the AER. Dr Mountain stated:

> I don't believe that the COAG Energy Council is able to agree arrangements for the review of the merits of the AER decisions that will actually support the authority of the AER and actually promote higher quality decisions…I believe nothing is better than a COAG Energy Council's possible 'something' and, for this reason, I think the legislation is a step in the right direction.[54]

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49 Energy Networks Australia, *Submission 5*, pp. 1–2; Mr Paul Italiano, TransGrid, *Committee Hansard*, 3 October 2017, p. 17; Mr Lance McCallum, Australian Council of Trade Unions, *Committee Hansard*, 3 October 2017, p. 2.

50 Mr Paul Italiano, TransGrid, *Committee Hansard*, 3 October 2017, p. 18.

51 Frontier Economics, *Submission 2*, p. 9.

52 Energy Networks Australia, *Submission 5*, p. 2. See also Mr Andrew Dillon, Energy Networks Australia, *Committee Hansard*, 3 October 2017, pp. 12, 13.

53 Mr Andrew Dillion, Energy Networks Australia, *Committee Hansard*, 3 October 2017, p. 13.

54 Dr Bruce Mountain, *Committee Hansard*, 3 October 2017, p. 8.

2.47 The department provided the committee with evidence on the Commonwealth's efforts to address the shortcomings identified in limited merits review by the two reviews of the regime through the COAG Energy Council process.[55] The Commonwealth took the issues to the COAG Energy Council in December 2016 and April 2017. While there was support from two states for reform of limited merits review, other states did not agree to reform. The Minister commented on this issue in May 2017 and stated:

> The Federal Government has had a clear policy to reform the LMR process but states who own network assets like Queensland and New South Wales have stood in the way those reforms.[56]

2.48 Dr Bright noted that without unanimous agreement from ministers at COAG meetings, reform cannot be implemented through the COAG Energy Council process. In addition, Dr Bright stated that 'working through the council and the senior committee of officials, it became clear that those were entrenched positions that were not going to be changed'.[57] As a consequence, the Commonwealth:

> …ultimately decided earlier this year, or in the middle of this year, that consumers' interests would be better served by abolishing the regime through Commonwealth legislation. If the Commonwealth government hadn't taken that action, the status quo would have been maintained. The vast majority of stakeholders that we've consulted over the course of the review process agreed that the status quo was an unacceptable outcome.[58]

Need for review of regulatory decisions

2.49 A number of submitters supported the retention of limited merits review as it was argued that it provides 'an important layer of independent assessment which ensures the regulator is accountable for its decisions, through appropriate checks and balances' and provides an incentive for the AER to make considered an reasonable decisions.[59] Mr Italiano, TransGrid, stated that 'the purpose of a limited merits review is to provide an escape valve, a pressure release, when there is a dispute between an electricity network and a very powerful regulator'. Mr Italiano went on to conclude:

> The removal of LMR takes this safety net away from Australia. It exposes us to configuring our electricity system entirely according to the

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55 Dr Joanne Bright, Department of the Environment and Energy, *Committee Hansard*, 3 October 2017, p. 29.

56 Minister for the Environment and Energy, the Hon Josh Frydenberg, MP, 'States need to put energy consumers first', *Media release*, 24 May 2017.

57 Dr Joanne Bright, Department of the Environment and Energy, *Committee Hansard*, 3 October 2017, p. 32.

58 Ms Joann Wilkie, Department of the Environment and Energy, *Committee Hansard*, 3 October 2017, p. 29.

59 Frontier Economics, *Submission 2*, p. 1. See also Spark Infrastructure, *Submission 7*, p. 1; Infrastructure Partnerships Australia, *Submission 9*, p. 2.

> interpretation of an economic regulator based here in Melbourne without the opportunity to enter into any appeal or review.[60]

2.50 The Queensland Law Society also commented that, in its view, 'the regulator does not always make informed, rational decisions'. It noted that the majority of the AER's decisions have been overturned'.[61] The Queensland Law Society concluded that:

> Reviews of administrative decisions are a fundamental part of the operations of a democratic society. A decision made at first instance, which involves a significant assessment process against a number of legislative criteria is capable of being erroneous in a number of ways. Abolishing the right to have this decision reviewed may create unjust and unintended consequences.[62]

2.51 Other submitters similarly argued that the number of AER decisions overturned demonstrated the need to retain the limited merits review.[63] It was also noted that the limited merits review regime discouraged frivolous appeals as, currently, review is only available by:

- establishing that the AER has made one of a specified set of errors; and
- determining that correcting that error would result in a materially preferable decision in the long-term interests of consumers.[64]

2.52 Dr Mountain provided evidence on the review of AER decisions and commented that 'the opportunity to oversee a decision by a regulator is very valuable and very important' particularly as AER decisions are worth many billions of dollars, and have consequences for investors, employees and consumers. However, Dr Mountain added that:

> …inadequate arrangements for merits review can detrimentally affect the quality of the regulator's decision, even if they are not actually reviewed, and the final decision from a body that hears a challenge may be worse than the first decision. So, in short, badly designed arrangements for review can actually result in lower quality decisions not higher quality decisions.[65]

2.53 Dr Mountain went on to voice concern about the use of a judge-led organisation in a policymaking role and concluded that the existing institutional

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60 Mr Paul Italiano, TransGrid, *Committee Hansard,* 3 October 2017, p. 17.

61 Queensland Law Society, *Submission 11*, p. 2.

62 Queensland Law Society, *Submission 11*, p. 2.

63 Frontier Economics, *Submission 2*, p. 4; Mr Paul Italiano, Chief Executive Officer, TransGrid, *Committee Hansard*, 3 October 2017, p. 18.

64 Frontier Economics, *Submission 2*, pp. 4–5. See also Queensland Law Society, *Submission 11*, p. 2.

65 Dr Bruce Mountain, *Committee Hansard*, 3 October 2017, p. 8.

arrangement is unable to deliver a merits review regime that improves the quality of decisions.[66]

2.54 The argument put to the committee by some submitters that the limited merits review regime is effective because the AER's decisions have been overturned was addressed by PIAC. Ms Mansour noted that there are often many alternative decisions that could be made by the AER within different economic parameters, many of which would be correct. Ms Mansour went on to comment:

> I think that it's a mischaracterisation to say that the tribunal overturning or reviewing the decisions of the AER proves that the AER is getting it wrong legally or otherwise.[67]

2.55 The department also responded to this argument and commented that limited merits review regime was reformed in 2013 'with the intention that it would steer the process away from error correction per se—looking for minor errors within the regulators' decisions—to a situation where you'd only see a decision of the regulator overturned when it was demonstrably in the long-term interests of consumers'.[68]

Impact on investment certainty

2.56 The risk of the abolition of limited merits review having a detrimental effect on investment certainty was seen as a significant issue by some submitters.[69] It was argued that without the accountability afforded by limited merits review, investor confidence would be adversely affected and would therefore pursue higher risk premiums.

2.57 TransGrid, for example, commented that investors in electricity networks commit a substantial amount of capital to electricity networks, and seek reassurance from 'a stable, well-functioning regulatory regime' that includes the availability of a merits review of revenue determinations by the regulator.[70] TransGrid went on to state that the removal of limited merits review would create a perceived sovereign risk for investors and 'this would likely result in an increase in the cost of capital for networks'. Submitters commented that any increase in capital costs would put upward pressure on prices for consumers.[71]

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66 Dr Bruce Mountain, *Committee Hansard*, 3 October 2017, p. 9.

67 Ms Julia Mansour, Public Interest Advocacy Centre, *Committee Hansard*, 3 October 2017, p. 26.

68 Dr Joanne Bright, Department of the Environment and Energy, *Committee Hansard*, 3 October 2017, p. 32.

69 Electrical Trades Union, *Submission 1*, p. 11; Spark Infrastructure, *Submission 7*, p. 1; TransGrid, *Submission 8*, p. 4; Queensland Law Society, *Submission 11*, pp. 2–3; Mr Andrew Dillon, Energy Networks Australia, *Committee Hansard*, 3 October 2017, p. 12.

70 TransGrid, *Submission 8*, p. 4.

71 Frontier Economics, *Submission 2*, p. 5; Energy Networks Australia, *Submission 5*, p. 2; TransGrid, *Submission 8*, p. 5.

2.58 In addition, it was argued there may be insufficient investment in networks if the AER does not allow for increased cost of capital. Frontier Economics stated that this would impact on the safety, reliability and security of the electricity grid and gas supply for consumers (both residential and commercial).[72]

2.59 The committee received evidence which did not support this view. Dr Mountain commented that businesses 'want policy certainty; they can deal with lack of certainty in business'. Dr Mountain added:

> To me, as an investor, if I had known there was a durable framework that wasn't subject to review all the time, wasn't subject to policy change and wasn't so very brittle as ours is evidently through it failures, that would have given greater certainty on investment. So I don't draw a link by any manner of means between having an arrangement for merits review and investor certainty. In fact, I would think a low-quality regime for merits review undermines at least one of the variables that impacts the charge for capital.[73]

Long-term interests of consumers

2.60 A number of submitters argued that it is in the long-term interests of consumers to have a system of limited merits review as the correction of material errors in AER decisions and improving the quality of regulatory decision making is of benefit to consumers.[74] In addition, it was argued that the Commonwealth Government, in seeking to abolish limited merits review, is only focussing on one aspect of the long-term interests of consumers. As a consequence, submitters suggested that it is likely that the energy system will become less safe, reliable and secure which is not in the long-term interests of consumers.[75]

2.61 In relation to benefits for consumers through reduction of costs, Infrastructure Partnerships Australia argued that the Tribunal can only overturn AER decisions if it finds that the decision is not in the long-term customer interest. Infrastructure Partnerships Australia added that, with network prices are determined for a five year period, there will be no immediate impact on household energy bills.[76]

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72 Frontier Economics, *Submission 2*, p. 5.

73 Dr Bruce Mountain, *Committee Hansard*, 3 October 2017, pp. 9–10.

74 Energy Networks Australia, *Submission 5*, p. 2; IPA, *Submission 9*, p. 1.

75 Electrical Trades Union, *Submission 1*, p. 8; Frontier Economics, *Submission 2*, pp. 6, 7; Energy Networks Australia, *Submission 5*, p. 5; Queensland Law Society, *Submission 11*, p. 2.

76 Infrastructure Partnerships Australia, *Submission 9*, p. 3.

Impact on employees

2.62 A number of submitters expressed concerns that the bill is being used as 'blunt instrument' to address high energy prices for Australian households and businesses with little consideration for any unintended impacts on employees.[77]

2.63 The ACTU and Electrical Trades Union (ETU) pointed to the reviews of the 2015 AER decisions for NSW and ACT electricity distributors. As a consequence of the Tribunal's review, the ETU stated that 'an estimated 2,000 electricity maintenance jobs were saved across NSW and the ACT and the condition of those networks has avoided serious neglect'.[78]

2.64 The ETU explained that if network companies are forced to operate below recovery costs for the efficient operation of their businesses, workers will have very little protection when businesses decide the 'easiest path to reducing their costs is by downsizing' or terminating maintenance workers' employment and re-employing them under a contractor.[79] Mr Trevor Gauld, ETU representative, advised the committee that employment under a contractor is more precarious and safety may be compromised through the drive to get jobs completed.[80]

2.65 Mr Lance McCallum, ACTU, further commented that:

> The point that we're trying to make is that what these companies do when they get an unfavourable determination is, first, say, 'We're going to have to sack 1,500 or 2,000 workers.' We're here today to say please think about how this bill and removing LMR could potentially impact on workers. There is a very recent concrete example of how workers end up being caught in the crossfire when it comes to the regulatory AER process for poles and wires.[81]

2.66 The AER responded to comments in evidence concerning jobs in the sector. The AER stated that it sets an overall revenue allowance; it is up to the business to decide how it operates, including how much money it spends on operations and maintenance.[82] The department added that:

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77 Australian Council of Trade Unions, *Submission 4*, p. 3; Electrical Trades Union, *Submission 3*, pp. 7–8.

78 Electrical Trades Union, *Submission 3*, p. 8.

79 Mr Trevor Gauld, Electrical Trades Union, *Committee Hansard*, 3 October 2017, pp. 2–3. See also Mr Lance McCallum, Australian Council of Trade Unions,, *Committee Hansard*, 3 October 2017, p. 5.

80 Mr Trevor Gauld, Electrical Trades Union, *Committee Hansard*, 3 October 2017, p. 3.

81 Mr Lance McCallum, Australian Council of Trade Unions, *Committee Hansard*, 3 October 2017, p. 5.

82 Mr Warwick Anderson, Australian Energy Regulator, *Committee Hansard*, 3 October 2017, p. 38.

> Ultimately, when it comes to the impact on the workforce of an organisation, that will be a commercial decision on the part of the business concerned. The regulator sets a revenue allowance, and essentially it will be up to the business to determine what that means for its workforce in any given situation.[83]

Impact on network maintenance

2.67 A number of submitters argued that abolishing the limited merits review regime will lead to cuts to maintenance programs and underinvestment in network infrastructure. As a consequence, it was claimed, reliability and safety will be undermined.[84] Frontier Economics, for example, commented that should an AER decision force businesses to recover revenues below the efficient costs they need to incur in order to supply energy services safely, reliably and securely to consumers, a rational response 'would be for regulated businesses to withhold otherwise efficient and necessary investments'.[85]

2.68 Both the ACTU and ETU raised similar concerns. Mr Gauld pointed to cost saving by companies such reviewing maintenance cycles, lengthening the times between essential maintenance and decreasing the level of vegetation management.[86] The ETU also submitted that years of underinvestment and neglect across networks has led to electrical outages, faults and fatalities, culminating in one of the worst bushfires in the country——the 2009 Black Saturday bushfires.[87]

2.69 In response to concerns about network maintenance, the department commented that the regulatory framework was adequately designed to ensure that safety of the network is maintained. Dr Bright explained that the AER, in making decisions:

> …takes into account not just price impacts but the extent to which other aspects of the national energy objectives are going to be delivered, including reliability, safety et cetera. The networks are responsible under licensing conditions to state governments for meeting reliability standards, and there are also incentive schemes that are in place through the AER to ensure that they don't just have an incentive to deliver a minimum standard

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83 Dr Joanne Bright, Department of the Environment and Energy, *Committee Hansard*, 3 October 2017, p. 33.

84 Mr Trevor Gauld, Electrical Trades Union, *Committee Hansard*, 3 October 2017, pp. 4–5. See also the Electrical Trades Union, *Submission 1*, pp. 7–8; Australian Council of Trade Unions, *Submission 4*, p. 3; Frontier Economics, *Submission 2*, p. 6; Electrical Trades Union, *Submission 1*, p. 9.

85 Frontier Economics, *Submission 2*, p. 5.

86 Mr Trevor Gauld, Electrical Trades Union, *Committee Hansard*, 3 October 2017, p. 5.

87 Frontier Economics, *Submission 2*, p. 6; Electrical Trades Union, *Submission 1*, p. 8.

> in that regard but actually to deliver above and beyond that wherever possible.[88]

2.70 The AER's view on maintenance was the same as that in relation to jobs: that this is a matter for businesses and they are in the best position to make decisions about their operations. While the AER looks at allocations to ensure that they look reasonable, the AER's interest is in 'a much broader array of options that businesses should be considering and not just at, say , maintenance versus new investment'.[89]

Retrospectivity

2.71 The Queensland Law Society raised concerns about the retrospective application of the bill as the transitional provisions in item 5 (application of proposed section 44AAIA) and item 6 (application of proposed section 44ZZMAA) apply in 'relation to a decision that is made before, on or after the commencement of this schedule'. The Queensland Law Society stated that the amendments 'will create uncertainty for the parties involved' and 'create unjust and unforeseeable outcomes'.[90]

2.72 In response to these concerns, the department noted that the transitional arrangements 'allow processes underway at the time of the Prime Minister's announcement to see out their course'. Current proceedings before the Full Federal Court that may result in a matter being referred back to the Tribunal after the legislation to abolish the regime has been passed are also covered. The department added that 'if that were to occur, the tribunal would still be allowed to perform its role in that situation'.

2.73 The department further stated that the next relevant AER decisions are due in November 2017, 'and we believe that the abolition, having been announced in June, provides stakeholders ample notice of the government's intention that those decisions in November will not be subjected to the limited merits review should the legislation be passed'.[91]

Judicial review

2.74 Judicial review of AER decisions will remain available following abolition of limited merits review. Submitters noted while access to judicial review was available it was viewed as not being an adequate avenue for redress. Infrastructure Partnerships Australia argued that under judicial review, the regulator's judgement and technical

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88 Dr Joanne Bright, Department of the Environment and Energy, *Committee Hansard*, 3 October 2017, pp. 30–31.

89 Mr Warwick Anderson, Australian Energy Regulator, *Committee Hansard*, 3 October 2017, p. 38.

90 Queensland Law Society, *Submission 11*, p. 2.

91 Ms Joann Wilkie, Department of the Environment and Energy, *Committee Hansard*, 3 October 2017, p. 30.

competence on key issues are not tested, but rather their competence in ensuring the law has been followed.[92] Infrastructure Partnerships Australia stated:

> …this means a poor decision by the regulator will stand—provided the regulator applies the right process, to deliver the wrong answer.[93]

2.75 TransGrid also commented that stakeholders are likely to increase their use of judicial review 'which is a far less effective process'.[94]

2.76 However, PIAC argued that judicial review was an adequate safeguard and stated:

> If it's our belief that the regulator, for example, has gone outside the boundaries of the law, including by relying on considerations that are irrelevant to its task, then judicial review will be an adequate safeguard there.[95]

2.77 However, concerns were raised about the difficulties of some groups, including consumer groups and unions, to participate in judicial review both in relation to issues around standing, legal costs and potential adverse cost orders.[96]

2.78 In relation to standing, PIAC commented that the *Administrative Decisions (Judicial Review) Act 1977* (ADJR Act) requires a potential applicant for judicial review to establish that they are a 'person aggrieved' by a decision and that the decision in question affects their legal rights and/or obligations. As a consequence, applicants, such as consumers, have found it difficult to seek judicial review in the public interest. The network businesses, whose financial interests will be directly affected by the AER's determinations, can more easily satisfy these tests. PIAC was of the view that it is unlikely under the current legislative framework that consumer groups would be able to successfully apply for judicial review of the AER's determinations.[97]

2.79 The ETU also commented on the standing issue and advised the committee that it would have no standing in judicial review of AER decisions.[98]

2.80 A further barrier to judicial review is the risk of an adverse costs order. PIAC noted that cost protections for consumers were added to the limited merits

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92 Infrastructure Partnerships Australia, *Submission 9*, p. 2.

93 Infrastructure Partnerships Australia, *Submission 9*, p. 2.

94 TransGrid, *Submission 8*, p. 4.

95 Ms Julia Mansour, Public Interest Advocacy Centre, *Committee Hansard*, 3 October 2017, p. 27.

96 Mr Chris Alexander, Energy Consumers Australia, *Committee Hansard*, 3 October 2017, p. 35.

97 Public Interest Advocacy Centre, *Submission 6*, p. 4. See also Mr Craig Memery, Public Interest Advocacy Centre, *Committee Hansard*, 3 October 2017, pp. 25–26.

98 Mr Trevor Gauld, Electrical Trades Union, *Committee Hansard*, 3 October 2017, p. 3.

review regime in 2013. However, there are very limited cost protections for judicial review.

2.81 PIAC recommended that legislative amendments to address concerns about standing and cost orders and stated:

> In order to ensure continued rights of consumer participation in administrative review processes, the National Electricity Law and National Gas Law, as well as the ADJR Act, should explicitly guarantee standing for consumer groups in judicial review processes relating to the AER's decisions. Further consideration must also be given as to how the consumer protection against cost orders under the LMR review scheme can be preserved for judicial review hearings.[99]

2.82 The AER also suggested improvements to the regulatory process in relation to judicial review to ensure:

- while standing for consumer groups is not precluded in judicial review, to remove any doubt, legislation could guarantee standing for consumer groups in judicial review;
- consideration should be given to how the costs protections afforded to consumer groups under the limited merits review regime can be preserved for judicial review hearings.[100]

2.83 The department responded to issues related to judicial review. Dr Bright commented that the department would open to hearing views about standing in judicial review. However, the importance of effective engagement in the AER's primary decision process was emphasised. Dr Bright also noted that PIAC had successfully intervened in the New South Wales and ACT judicial review hearing and no costs orders were made against any of the parties in the appeal.[101]

2.84 Following evidence from the department, the committee received correspondence from PIAC. PIAC explained that while it was correct that it had made a successful intervention and obtained an order protecting it from costs, standing in judicial review had derived from its participation in limited merits review:

> PIAC's standing to intervene in those proceedings was derived from its participation as an applicant and intervener in the LMR proceedings in the Competition Tribunal. If LMR is abolished no consumer advocacy group seeking to participate in judicial review will have the same standing, or arguments in favour of cost protection, that PIAC had in those matters.
>
> It is for precisely this reason that PIAC stresses that, alongside the passage of this Bill, the Committee should recommend further legislative reforms to

99 Public Interest Advocacy Centre, *Submission 6*, p. 5.

100 Australian Energy Regulator, *Submission 3*, Attachment 1, pp. v–vi.

101 Dr Joanne Bright, Department of the Environment and Energy, *Committee Hansard*, 3 October 2017, p. 31.

give consumer organisations a statutory right of standing in judicial review proceedings, and protection from adverse cost orders.[102]

Conclusions

2.85 The limited merits review was introduced with the intention of providing a limited form of review of AER decisions to address regulatory errors and to improve accountability in regulatory decision making. Two reviews of limited merits review have found that this has not been the case: use of limited merits review has become a routine part of the regulatory process and has contributed to increased energy prices for consumers.

2.86 Ministers at the COAG Energy Council's December 2016 meeting agreed that the limited merits review regime had failed to meet its policy intent and had contributed to increasing energy prices for consumers. While there was no agreement reached regarding the abolition of the limited merits review regime, the Commonwealth indicated it was in favour of abolition. Against this background of rising energy prices and supply uncertainty, on 20 June 2017, the Government took action to put downward pressure on power prices and to stop network businesses from gaming the regulatory system by announcing the abolition of the limited merits review.

2.87 The committee is of the view that the limited merits review regime has been in operation for sufficient time to test its effectiveness. However, even with the introduction of reforms in 2013, limited merits review has failed to deliver the national energy objectives—the promotion of consumers' long-term interests with respect to price, quality, safety, reliability and security of energy supply—as originally envisaged by policymakers.

2.88 The limited merits review regime has contributed to outcomes that not are in consumers' long-term interests. The committee received evidence that the features of the regime, including its wide scope and low threshold to access the appeal, allow network businesses to use it to their commercial benefit at the expense of consumers. In effect, the Tribunal is being used as a second regulator. This has resulted in a highly legalistic, complex and costly review process which acts as a barrier to the engagement of other stakeholders, such as consumer groups.

2.89 In addition, the committee notes that limited merits review has compromised the regulatory process. The committee received evidence which indicated that this has adversely affected the AER's decision making processes with limited merits review becoming the primary focus. The committee considers that this is a highly undesirable outcome.

2.90 The committee also notes that the Tribunal is not resourced to undertake the complex tasks involved in proper network regulation and the timeframes for Tribunal

102 Public Interest Advocacy Centre, Additional Information, dated 4 October 2017, p. 1.

decision making are significantly shorter than those of the AER. This is in contrast to the extensive process undertaken by the AER to develop its revenue and access determinations. Consequently, this extensive process undertaken by the regulator in its primary decision making process cannot be replicated by limited merits review.

2.91 The committee considers that with the abolition of limited merits review, the focus will shift back to the AER as the primary decision maker, with judicial review of AER decisions remaining available. The committee believes the current AER's extensive inquiry, analysis and consultation undertaken in the regulator's primary decision making process provides appropriate opportunities for all stakeholders, including consumer groups, unions and businesses, to express their views and to effectively engage in the process.

2.92 The committee further notes that the Senior Committee of Officials of the COAG Energy Council has released a consultation paper seeking feedback on how to address any barriers limiting consumer participation in the AER's revenue determinations and associated regulatory processes. The committee welcomes this initiative. The committee considers that effective participation and consultation of all stakeholders, including consumers and unions, in the regulatory process is vital.

2.93 The committee notes the evidence from the AER that, since the commencement of the COAG Energy Council review, there had been perceptible and positive changes in the engagement between some network businesses, their customers and the AER. The AER also indicated that it is working to ensure that consumers are fully included in its decision making processes. The committee is strongly of the view that the AER must take all steps to ensure that consumer groups, relevant unions and stakeholders are able to fully participate in the regulatory process particularly in relation to revenue determinations and that this should be included in the AER's statements of expectations.[103]

Recommendation 1

2.94 The committee recommends that the Commonwealth Government gives consideration to amending the statements of expectations for the Australian Energy Regulator to emphasise that more effective engagement of consumers, relevant unions and stakeholders is expected.

2.95 The committee also received evidence from stakeholders pointing to greater engagement between customers and businesses. The committee considers that this is a very positive development.

103 In 2014, the COAG Energy Council and Australian Government published separate statements of expectations for the AER under accountability and performance frameworks. See https://www.aer.gov.au/publications/corporate-documents/aer-statement-of-intent-2017%E2%80%9318

2.96 The committee supports the abolition of limited merits review. It considers that the abolition of limited merits review will ensure that regulatory regime is focussed on the long-term interests of consumers and businesses and ensure an efficient and sustainable national energy market.

2.97 The committee also supports mechanisms to ensure standing in judicial review for stakeholders such as consumer groups and unions and for their protection against adverse cost orders. The committee notes that a consultation process on consumer participation in the regulatory process is underway. These matters should be included in that process and that further consideration be given to standing and costs issues once the consultations have been completed.

Recommendation 2

2.98 The committee recommends that the Competition and Consumer Amendment (Abolition of Limited Merits Review) Bill 2017 be passed.

Senator Jonathon Duniam
Chair