Standing Council on Energy and Resources

Expert Panel's Stage Two Report on the review of the Limited Merits Review Regime

Submission

October 2012

1 Summary

This is a submission from the Australian Energy Regulator (**AER**) and the Australian Competition and Consumer Commission (**ACCC**) to the Standing Council on Energy and Resources (**SCER**) regarding the Expert Panel's recommendations in its Stage Two Report concerning the review of the Limited Merits Review (**LMR**) regime.[1]

The Expert Panel has properly characterised the problems with the LMR regime. It is clear that reform is needed to achieve the aim of the LMR regime. That aim is to arrive at a regulatory determination that achieves outcomes that are in the long-term interests of consumers.[2] This necessarily involves a holistic or overall assessment of a regulatory determination. It is also clear that reform is needed to ensure that there is practical, equitable and open access to all interested parties.

Building upon the recommendations of the Expert Panel that we support, we consider that the recommendations necessary to address the problems with the LMR regime can be implemented by:

- a single ground of review that requires an applicant to establish that a materially preferable decision exists, in the sense that the alternative decision would better serve the long term interests of consumers;[3]
- establishing appropriate limitations, including a requirement that there be no new material before the review body;
- maintaining the role of the Australian Competition Tribunal (**Tribunal**) as the review body and requiring it to undertake an administrative review of regulatory determinations;[4] and
- establishing a well-funded consumer advocate which can ensure that there is effective consumer involvement.[5]

These reforms will involve challenges that require careful consideration.

A number of the Expert Panel's recommendations are not relevant to the reform of the LMR regime, including the need to revisit the AER's structure.[6] However, this submission briefly responds to this recommendation as well.

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1 Professor George Yarrow, The Hon Michael Egan and Dr John Tamblyn, *Review of the Limited Merits Review Regime: Stage Two Report*, 30 September 2012 (**Stage Two Report**).

2 Ibid, pp 4 and 28.

3 Ibid, p 41: recommendation (iv).

4 Ibid, p 48: recommendation (x).

5 Ibid, p 60.

6 Ibid, p 61.

2 The required reforms

Reform to the LMR regime is required to achieve the aim of the LMR regime. That aim is to arrive at a regulatory determination that achieves the long-term interests of consumers. Reform is also required to ensure that there is practical, equitable and open access to all interested parties.

We consider that these reforms can be implemented by:

- a single ground of review that requires an applicant to establish that a materially preferable decision exists, in the sense that the alternative decision would better serve the long term interests of consumers;[7]
- establishing appropriate limitations, including a requirement that there be no new material before the review body;
- maintaining the role of the Tribunal as the review body for regulatory determinations and requiring it to undertake an administrative review of regulatory determinations;[8] and
- establishing a well-funded consumer advocate which can ensure that there is effective consumer involvement.[9]

2.1 The single ground of review

A properly specified single ground of review, accompanied with appropriate limitations, is vital to address the problems identified by the Expert Panel.

We consider that the recommendation that the current grounds of review should be replaced with a single ground of review, expressed in terms of whether a materially preferable decision exists, has merit.[10]

This recommendation has three benefits. Firstly, it ensures the review process has both upside and downside risk for all parties concerned, rather than the current bias to the upside in favour of the regulated business as identified by the Expert Panel.[11] A materially preferable decision at the end of the day should not be necessarily favourable or unfavourable to the regulated business once all relevant matters have been considered and all interested parties have been heard. This places the appropriate incentive upon a regulated business to carefully consider whether it should seek review. Secondly, it would provide the opportunity for the

7 Ibid, p 41: recommendation (iv).
8 Ibid, p 48: recommendation (x).
9 Ibid, p 60.
10 Ibid, p 41: recommendation (iv).
11 Ibid, p 40.

review body to review the regulatory determination holistically, so that a materially preferable decision that is in the long-term interests of consumers can be identified. Thirdly, it would remove the error-focused character of the current LMR regime that inappropriately introduces the concept of correct and incorrect decisions. This character has contributed to the failure of the LMR regime to lead to a holistic assessment of the regulatory determination in the long-term interests of consumers.

However, a regulatory determination is complex. There is a risk that the task of determining whether a materially preferable decision exists may be substantial and resource-intensive. At one extreme, this task might approximate a *de novo* review of a regulatory determination. Such an outcome is inappropriate in the context of the LMR regime. The perceived confidence in the LMR regime may also be impacted.

Focussing on whether a materially preferable decision exists will also assist the development of regulatory precedent, with issues of principle being resolved and able to be implemented in subsequent regulatory determinations. We expect that this approach will reduce the incidence of continual reviews on the same issues, as has been the experience under the current LMR regime.

In any case, the ground of review needs to be carefully drawn so as to not reintroduce the error-focused nature that has led to the failure of the current LMR regime. As discussed below, so do any accompanying set of limitations. The specific details of the ground of review and accompanying limitations are complex matters that demands careful consideration. Properly implemented, an appropriately specified ground of review and set of limitations has the real potential to result in a review that places the appropriate incentives upon regulated businesses, is not so significant that it undermines the limited nature of the LMR regime, and is capable of leading to outcomes that are in the long-term interests of consumers.

Conversely, an inappropriately specified ground of review and set of limitations runs the real risk of repeating the failings of the current LMR regime, specifically with respect to the interaction between the grounds of review and section 71O of the *National Electricity Law* (**NEL**) and section 258 of the *National Gas Law* (**NGL**). If this is the case, the LMR regime will continue to be incapable of leading to outcomes that are necessarily in the long-term interests of consumers.

2.2 Appropriate limitations including no new material

As the Expert Panel recognises, the risk that determining whether a materially preferable decision exists may be substantial and resource-intensive underlines the need to build

appropriate and effective limitations into the LMR regime.[12] In this regard, we support the Expert Panel's recommendations that there should be materiality thresholds and time limits.[13]

We do not support the Expert Panel's recommendation that the material before the AER should form the starting point of an investigative review.[14] Instead, the review should be administrative in nature and limited to the material before the AER.

The regulated business should be under an obligation to place all of its cards on the table before the regulator so that the regulator has the opportunity to arrive at a regulatory determination that best achieves the long-term interests of consumers. If the role of the review body is to determine whether a materially preferable decision exists, that should only be done on the basis of the same material that was before the AER when it made the regulatory determination. Allowing for exceptions for the introduction of new material will create incentives to exploit the LMR regime and effectively contribute to the risk that a review might approximate a *de novo* review.

It remains an open question as to whether these limitations are sufficient to guard against a review no longer reflecting the limited nature of the LMR regime. This concern may also be mitigated by placing the onus upon an applicant to clearly articulate to the satisfaction of the review body that there is a real possibility that a materially preferable decision exists, what that decision might look like and why it would be materially preferable. Importantly, it is not enough for an applicant to simply identify deficiencies in a regulatory determination absent a compelling argument as to why the overall regulatory determination, having regard to the revenue and pricing principles, will not contribute to the achievement of the national electricity objective or the national gas objective and therefore is ultimately not in the long-term interests of consumers.

2.3 The Tribunal is the appropriate review body

The most appropriate review body to undertake a review of a regulatory determination is the Australian Competition Tribunal. The Tribunal is an established review body that has existed since the commencement of Australia's competition laws.[15] It performs an integral role in the current national competition and regulatory framework. Replacing the Tribunal with the proposed Australian Energy Appeals Authority (**AEAA**) is unnecessary. Maintaining the Tribunal as a review body and requiring it to undertake an administrative review is by far the simplest, most effective and most streamlined reform regarding the appropriate review body.

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12 Ibid, p 35.

13 Ibid, pp 35, 38–41 and 47.

14 Ibid, pp 39, 47 and 48.

15 AER, *Standing Council on Energy and Resources, Expert Panel, Review of the Limited Merits Review Regime, Stage Two, Submission*, August 2012 (**AER Stage Two Submission**), p 4.

2.3.1 The proposed AEAA

The recommendation to establish the AEAA will involve significant costs and is unlikely to be as simply and efficiently achieved as the Expert Panel suggests.

Firstly, the proposed AEAA involves the real risk of a conflict of interest. Staff of the Australian Energy Market Commission (**AEMC**) have rule making responsibilities. It would be inappropriate for those staff to assist the AEAA in reviewing a determination. An essential element of reviewing a determination requires an independent application of those same rules to a regulated business.

Secondly, the AEMC is a body established under State legislation.[16] Given the AER is a Commonwealth body, there are complex legal issues that will require careful consideration, including whether the AEAA would fall under the jurisdiction of the Federal Court of Australia or the various State Supreme Courts, or both. If the jurisdiction lies with the various State Supreme Courts, the potentially for divergent and inconsistent interpretations and applications of the national framework may put at risk achieving the objectives of the national energy framework as originally envisaged in the Australian Energy Market Agreement (**AEMA**). Specifically, paragraph 2.1(b)(ii) of the AEMA provides (emphasis added):

> The objective of this agreement are: ... the establishment of a framework for further reform to: ... streamline and improve the quality of economic regulation across energy markets to lower the cost and complexity of regulation facing investors, enhance regulatory certainty, and lower barriers to competition.

2.3.2 An administrative process

Much has been said about the overly-legalistic and adversarial nature of reviews under the LMR regime before the Tribunal.[17] This problem is best addressed by requiring the Tribunal to adopt an administrative approach, and not an investigative approach as the Expert Panel has recommended.[18]

An investigative approach is inappropriate in circumstances where a review is meant to be limited in nature and where the review body is *correctly* limited to the material before the regulator. An investigative approach runs the risk of the review body going beyond that of the regulator's inquiry or indeed, 'an investigatory effort that would be incremental to that of the primary decision maker'.[19] This simply does not sit well with the objective of limiting a

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16 *Australian Energy Market Commission Establishment Act 2004* (SA), s 5.

17 See AER, *Standing Council on Energy and Resources, Expert Panel, Review of the Limited Merits Review Regime, Interim Stage One Report and Consultation Papers 1 and 2, Submission*, June 2012 (**AER Stage One Submission**); AER Stage Two Submission.

18 Stage Two Report, p 42: recommendation (v).

19 Ibid, p 35.

review by restricting the review body to the material before the regulator. It also runs the risk of a regulated business gaming the process by withholding other possible avenues of inquiry that need not necessarily be contained in material it puts before the regulator.

As the AER has previously argued, given the complexity and breadth of a regulatory determination, and that the Tribunal is and was always intended to be an administrative body, the structure and the level of formality necessary in a review process should be no more than that of an administrative process. There are ways the process before the Tribunal can be made more administrative. For example:

- the Tribunal should be required to publish a practice note outlining its processes;
- the review should be conducted on the papers and supplemented by oral hearings or round table discussions;
- oral hearings or round table discussions should not be heard in a court room;
- legal advisers should only be involved in resolving questions of law.[20]

2.3.3 The perceived resources and reluctance of the Tribunal

One reason why the Expert Panel has recommended the establishment of the AEAA is a perceived concern that the Tribunal is inadequately resourced and reluctant to undertake a holistic review of a regulatory determination.[21]

First, additional resources can be made available to the Tribunal via a number of arrangements. Staff-secondment arrangements with other regulatory agencies is one example.[22]

Secondly, the reason behind the Tribunal's apparent reluctance to undertake a holistic review of a regulatory determination is misunderstood. It is not a consequence of the composition or the capacity of the Tribunal but rather it is a direct result of the LMR regime. The Tribunal is restricted by and operates within the confines of the NEL and the NGL. It has been established that under the current LMR regime, section 71O of the NEL and section 258 of the NGL, notwithstanding their intended effect, do not operate to allow the Tribunal (nor the AER) to ensure that a regulatory determination under review is reviewed holistically.[23] The Tribunal has demonstrated over its long history that it has no difficulty in arriving at its own holistic view of matters in the other parts of its competition and regulatory jurisdictions.

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20 These suggestions build upon those proposed by Finkelstein QC to the Expert Panel: see R Finkelstein QC, *Submission to Expert Panel*, 12 June 2012, pp 2, 3 and 7; AER Stage Two Submission, pp 4 and 5.

21 Stage Two Report, p 49.

22 AER Stage One Submission, pp 14 and 18; AER Stage Two Submission, pp 4 and 5.

23 Stage Two Report, p 33 and Annex 7: Acting Solicitor General's Opinion No. 22 of 2012 dated 12 September 2012.

Accordingly, the perceived concerns about the resources and the reluctance of the Tribunal are misunderstood. These matters can be addressed by simply providing the Tribunal with appropriate resources and ensuring the LMR regime allows it to review a regulatory determination holistically.

2.4 A well-resourced consumer advocate

The Expert Panel argues that the role of a consumer advocate would be diminished if the process is more investigative in nature and accessible to consumers.[24] They also raise the concern that it is important that more than one consumer voice is heard.[25]

The case for improving the accessibility of the review process to consumers and increasing their involvement is uncontroversial. The LMR regime should be amended to provide a right for all interested parties to either seek review of a regulatory determination or to intervene in a review process.

These factors do not affect the need for a consumer advocate.

A fundamental barrier to effective consumer involvement is the complexity of regulatory determinations. This complexity will remain even if the AEMC's draft rules regarding the economic regulation of network service providers is implemented in November 2012.[26] It is this complexity that demands significant resources and expertise in order for any interested party to meaningful participate in both the primary regulatory determination process and any subsequent review process.

At the review stage, an effective representative of the interests of consumers is imperative. As the independent regulator and impartial decision-maker, this is not the AER's role.[27] An effective representative would also make it much more likely that any outcome of a review is in the long-term interests of consumers.

A well-resourced consumer advocate is therefore vital to effective consumer involvement.

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24 Ibid, p 60.

25 Ibid.

26 AEMC, *Economic Regulation of Network Service Providers, and Price and Revenue Regulation of Gas Services, Draft Rule Determinations*, 23 August 2012, p ix.

27 As the independent and impartial primary decision-maker, this to be the appropriate role for the AER. Generally, a primary decision-maker not acting as a protagonist before a merits review tribunal is consistent with the 'Hardiman' principle expressed by the High Court in the case *R v Australian Broadcasting Tribunal; Ex parte Hardiman* (1980) 144 CLR 13 at 35 and 36.

3 Recommendations not relevant to the LMR regime

The Expert Panel has made a number of recommendations that are not relevant to reforming the LMR regime. This includes revisiting the AER's structure.[28]

Firstly, the Expert Panel's recommendation that the AER's structure be revisited is outside the scope of the Expert Panel's terms of reference.[29] The AER's institutional and governance arrangements are not relevant to reforming the LMR regime.

Secondly, any discussion of the AER's independence from the ACCC misses the vital point that the AER is established as a regulator that is independent of both government and the energy sector.[30] It has an independent Board with an independent Chair appointed with the agreement of all State and Territory Governments.[31] The ACCC provides the AER with dedicated staff, resources and facilities. The AER's independence from government and the energy sector is the primary issue and discussion about the AER's institutional and governance arrangements only distracts from and obscures that point.

Thirdly, there are significant benefits from the current institutional arrangements of having the AER and the ACCC together. Separating the two risks the loss of significant synergies and efficiencies that the AER currently benefits from through the conglomerate regulatory arrangements it shares with the ACCC.

The AER has spent seven years developing its operational capability. It would be high risk to alter institutional arrangements at this point in time and compromise the knowledge and experience gained over time and impacting on the predictability that continuity of process, staff and institutional behaviour brings. It also risks leading to a loss of staff with relevant experience.

Technological change, consumer expectations, liberalised markets and the scope and complexity of economic regulation requires an extremely high level of coordination between the regulatory, competition and consumer protection functions. The current model, which internalises coordination within the AER and the ACCC, provides a highly effective and efficient way of managing this task for the following reasons.

Consistency of regulatory decision-making across sectors

The current model facilitates consistency of regulatory decision-making across sectors. This avoids distortions in investment decisions based on different regulatory approaches.

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28 Stage Two Report, p 61.

29 Ibid, p 61.

30 *Competition and Consumer Act 2010* (Cth), Part IIIAA.

31 Ibid, ss 44AM and 44AR.

Complementary expertise, competencies and knowledge

Network regulation is a core competency of the ACCC in the performance of its regulatory functions in respect of the communications, rail, ports, water and postal services. Similar analytical approaches and thinking are required in regulating the monopoly elements of the energy industry.[32]

The AER has consumer protection and education responsibilities under the National Energy Customer Framework that complement the ACCC's responsibilities under the *Australian Consumer Law*.[33] The ACCC also uses the AER's energy expertise to inform its consideration of and decision-making in competition law issues in the energy sector.

Further, the current model achieves significant economies of scale and scope. The AER draws on the ACCC's specialised legal and economic advice and administrative corporate resources.

A pro-competitive culture

The current model fosters a 'pro-competitive' rather than a 'regulatory' culture that focuses the important competition objective in economic regulation. This was a fundamental argument supporting the model arising from the Hilmer Review.[34]

Reduces the risk of regulatory capture

The current model reduces the risk of capture by industry participants. The AER and the ACCC, together, is a stronger body able to exercise its independence freely. There is a higher risk of capture and associated loss of independent decision making if a new entity external to the ACCC is funded through industry levies.[35]

International experience

Consistent with recent international experience, some countries are contemplating or implementing similar institutional arrangements, the latest being Spain.[36] A decision to combine competition, economic regulation and consumer protection in the Netherlands is due

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32 In a report to COAG, the MCE noted that '[t]he proposed staffing arrangements will allow the AER and AEMC to be provided with the best available expertise from the ACCC, other regulatory bodies and elsewhere': Ministerial Council on Energy, *Report to the Council of Australian Governments: Reform of Energy Markets*, 11 December 2003, p 16.

33 See, e.g., *Competition and Consumer Act 2010* (Cth), Schedule 2 (*Australian Consumer Law*), Part 2-1 (misleading and deceptive conduct) and Part 2-3 (unfair contract terms).

34 Federick J Hilmer, *National Competition Policy Review*, 1993, Chapter 9.

35 Ibid, pp 326 and 328.

36 European Commission, *Assessment of the 2012 National Reform Programme and Stability Programme for Spain*, 5 May 2012, p 22.

to take effect in January 2013.[37] The United Kingdom and New Zealand are also examples of countries that are moving towards agency consolidation.[38] Other countries have also developed umbrella organisations to bring different regulators together to exchange information and coordinate for consistency, such as Germany.[39] The international trend is towards consolidation and there is no international evidence of organisations moving from their existing structures into more narrowly defined units.

[37] Netherlands Competition Authority, *Press Release: Bill on ACM Establishment Act submitted to the Dutch Parliament*, 29 February 2012; Netherlands Consumer Authority, *2012-2013 Agenda*, p 6.

[38] Infrastructure Consultative Committee, *Final Report of the Infrastructure Consultative Committee*, 5 June 2009, pp 59 and 60.

[39] In Germany the Federal Network Agency is primarily responsible for economic regulation of gas, electricity, rail, post and telecommunications services: see Infrastructure Consultative Committee, *Final Report of the Infrastructure Consultative Committee*, 5 June 2009, p 60.