

# APPENDIX 2.2

Expert Panel Review of the Limited Merits Review - Stage Two Report

**REVIEW OF THE LIMITED MERITS REVIEW  
REGIME**

**STAGE TWO REPORT**

**Professor George Yarrow  
The Hon Michael Egan  
Dr John Tamblyn**

**30<sup>th</sup> September 2012**

## TABLE OF CONTENTS

<b>1.</b>	<b>INTRODUCTION: KEY FINDINGS AND RECOMMENDATIONS .....</b>	<b>2</b>
<b>2.</b>	<b>BACKGROUND TO THE STAGE TWO REPORT.....</b>	<b>10</b>
2.1	<i>The Limited Merits Review Regime.....</i>	10
2.2	<i>Background to the Current Review .....</i>	11
2.3	<i>Organisation of the Review of the LMR.....</i>	11
2.4	<i>Consultation .....</i>	18
<b>3.</b>	<b>THE PANEL’S APPROACH IN STAGE TWO .....</b>	<b>19</b>
3.1	<i>The Panel’s terms of reference and the breadth of its work.....</i>	19
3.2	<i>A central puzzle: a merits review regime that has not encompassed review of the merits of the principal decisions.....</i>	20
3.3	<i>Importance of relative certainty about outcomes .....</i>	20
3.4	<i>The July Discussion Paper: identifying salient characteristics of review regimes .....</i>	21
3.5	<i>Issues of institutional structure .....</i>	22
<b>4.</b>	<b>DISCUSSION OF ISSUES RAISED IN THE STAGE TWO PROCESS.....</b>	<b>23</b>
4.1	<i>The nature of merits review.....</i>	23
4.2	<i>The relevant context: price/revenue determinations .....</i>	24
4.3	<i>The relevant objectives.....</i>	25
4.4	<i>Requirement for review of substantive content of discretionary decision making.....</i>	28
4.5	<i>Separation of rule-making and enforcement .....</i>	29
4.6	<i>Grounds for appeal .....</i>	30
4.7	<i>The legal position.....</i>	32
4.8	<i>Keeping merits review ‘limited’ .....</i>	34
4.9	<i>Legitimacy and relative certainty.....</i>	35
<b>5.</b>	<b>THE PANEL’S RECOMMENDATIONS.....</b>	<b>37</b>
5.1	<i>Framework, structure and procedures for future energy limited merits review.....</i>	37
5.2	<i>Future institutional arrangements for energy merits review.....</i>	48
<b>6.</b>	<b>WIDER OBSERVATIONS ON THE REGULATORY REGIME AND POSSIBLE RULE CHANGES .....</b>	<b>57</b>
6.1	<i>Possible rule changes to improve the operation of the regulatory regime.....</i>	57
6.2	<i>Consumer engagement in earlier stages of the regulatory process.....</i>	59
6.3	<i>An independent AER?.....</i>	60
6.4	<i>Privatisation of NSPs .....</i>	63
6.5	<i>Pricing of network services .....</i>	64
	<b>ANNEX 1: COST-BENEFIT ASSESSMENT OF PROPOSALS .....</b>	<b>67</b>
	<b>ANNEX 2: THE DEBATE ABOUT TRIBUNALS .....</b>	<b>72</b>
	<b>ANNEX 3: POSSIBLE ORGANISATIONAL AND ADMINISTRATIVE ARRANGEMENTS FOR ESTABLISHMENT OF THE AEAA AS AN INDEPENDENT CONSTITUENT PART OF THE AEMC.....</b>	<b>78</b>
A. 3.1	<i>Functions of the AEAA.....</i>	78
A. 3.2	<i>Guiding principles for establishment of AEAA .....</i>	79
A. 3.3	<i>AEAA appointments process and cost recovery.....</i>	80
	<b>ANNEX 4: TERMS OF REFERENCE .....</b>	<b>83</b>
	<b>ANNEX 5: LIST OF SUBMISSIONS RECEIVED .....</b>	<b>88</b>
	<b>ANNEX 6: PUBLIC FORUM ATTENDEES .....</b>	<b>90</b>
A. 6.1	<i>Organisations at the Public Forum, Wednesday 9 May 2012 .....</i>	90
A. 6.2	<i>Organisations at the Public Forum, Monday 31 July 2012.....</i>	91

<b>ANNEX 7: ACTING SOLICITOR GENERAL'S OPINION NO. 22 OF 2012 DATED 12 SEPTEMBER 2012 .....</b>	<b>92</b>
<b>GLOSSARY / ACRONYMS .....</b>	<b>105</b>

## 1. INTRODUCTION: KEY FINDINGS AND RECOMMENDATIONS

In its Stage One Report the Panel concluded that the Limited Merits Review (LMR) regime established for electricity and gas networks was not working as policymakers intended. A number of specific examples of deviations between intentions and outcomes were cited, of which we subsequently (in the July Discussion Paper) drew attention to two in particular:

1. The tendency for the scope of reviews of regulatory decisions to be unduly narrow, such that the merits of reviewable decisions concerning overall allowable revenues/prices were themselves never assessed.
2. An insufficiency of attention to the National Electricity Objective (NEO) and National Gas Objective (NGO), and hence to the long-term interests of consumers, not only in the LMR process itself but also in business and regulatory decision making prior to the appeals stage.

Since the publication of the Stage One Report, the Panel's further investigations have not only tended to reinforce those earlier conclusions, but also provided us with clearer insight as to the major sources of the unintended consequences. In particular, we have reached the view that the way in which various 'limits' or constraints have collectively affected the review process has been a major contributory factor to the problems identified.

Among other things, these constraints have led to a situation where:

- In reality, the LMR regime is not a merits review in the normal sense: it is not directed at reviewing the merits, relative to available alternatives, of major regulatory decisions of interest, most notably the determination of overall allowable revenues and levels of charges of network service providers (NSPs). Rather the constraints direct review activity only toward certain aspects of the relevant decisions, and put obstacles in the way of consideration of other, potentially highly relevant factors. In effect, they create 'no-go' areas for reviewers.
- If uncorrected, the constraints set up a contest or 'game' focused less on reaching a preferable decision and more on changing the distribution of economic resources between NSP owners and customers or energy consumers, a contest in which consumers are at a distinct disadvantage. This is inconsistent with the NEO and NGO, and it can be expected to lead to excessive appeals activity. Constraints intended to limit the level of appeals activity appear to tend to have the opposite effect in practice.

In considering measures directed toward rectifying the position, the Panel has considered the possibilities of *de novo* review and reliance on judicial review only, which were the major alternatives considered by the Ministerial Council on Energy (MCE) at the time of the

introduction of the LMR regime. The Panel shares the view that neither of these options is preferable to a properly structured merits review regime. We are convinced of the contribution that merits review can make to better regulatory decision making, and, more specifically, we consider it to be an important component of a system of checks and balances that supports the independence of delegated regulation. It can be noted however that, if the Panel had been persuaded by those who believe that the regulatory arrangements imply that the primary regulator simply has to follow rules that afford it little discretion, we would have concluded that it would not be advantageous to augment the opportunities for challenge that are available via judicial review. It is because the Australian Energy Regulator (AER) can exercise significant discretionary powers that merits review has such an important potential role to play.

The Panel also shares the view that merits review can be developed in ways that limit the appeal activity to levels that are proportionate to the contribution that such activity makes to the relevant policy objectives. Whilst we consider the present arrangements unsatisfactory, a better implementation of the policy intent would be capable of addressing the major weaknesses.

Initially, the Panel thought that the way forward would be simply (a) to loosen some of the existing constraints on reviews that have served to create problems, and (b), where there were areas of ambiguity as to whether a constraint did or did not exist, of resolving that ambiguity in ways that expanded the scope of review, so that more relevant factors could be considered. It became increasingly clear to the Panel, however, that this path was fraught with difficulties of a kind that would be difficult to address because they lay deeper in the nature of the Australian tribunal system itself. The warnings and reservations came initially from Ray Finkelstein QC, a former President of the Australian Competition Tribunal (ACT), but they were confirmed in the views expressed by other senior legal figures, including in an opinion from Tom Howe QC, the Acting Solicitor General. In the end, it became clear that, in order to establish an effective system of review of the merits of major regulatory decisions, such as the overall allowable revenue/price decisions for NSPs, much more substantial change will be required.

In the light of this evidence the Panel concluded that it could not recommend the kinds of simple adjustments to the existing LMR regime that NSPs and their experts had advocated. There was no basis for developing an expectation that such measures would effectively address the problems identified, and the approach would introduce further uncertainties (about the effects of the measures) at a time when the legitimacy of the regulatory arrangements as a whole is under pressure. The Panel had little difficulty in concluding that it was not its task to come up with this type of ‘solution’.

In order to address the problems identified, the Panel has concluded that a more significant reorientation of the review process is warranted, as part of a more general reorientation of aspects of wider energy policy (made inevitable by climate change issues). Central to this shift is recognition that utility regulation is motivated by concerns about the interests of

consumers, both now and in the future. Just as ‘effective competition’ is sometimes defined as ‘competition that works well for the long-term interests of consumers’, we suggest that a working definition of ‘effective regulation’ is ‘regulation that works well for the long-term interests of consumers.’ It is an emphasis on the interests of current and (crucially) future consumers that provides policy with a stabilising focal point, and without it there is much greater risk of instability in objectives, a problem that delegated, independent regulation is intended to address.

Proceeding from these views, the Panel recommends that:

- Merits review should be capable of directly addressing regulatory decisions with material implications for consumer interests (there should be no ‘no-go areas’ for reviewers). The aim is to discover whether there is a materially preferable decision that could be adopted.
- The criteria for judging whether one decision is preferable to another should be identical to those of the primary regulator, and should be those specified in legislation, namely the NEO/NGO and the revenue and pricing principles, recognising that the ultimate end, and therefore the ultimate test, is the long-term interests of consumers (there should be no displacement of ends (consumer interests) by means to those ends such as economic efficiency, not least because not all efficient outcomes are in consumers’ interests).
- To put it beyond doubt that regulation of networks is directed toward promoting long term consumer interests, and to avoid the manifest economic error that promoting economic efficiency *necessarily* serves this purpose, the Panel recommends a very minor amendment to the NEO and NGO, which has no effect other than to remove what appears to be an ambiguity arising from the way these admirably specified objectives are currently expressed.
- Review should be investigative rather than adversarial in nature, and consumer views should be routinely invited at the review stage (review should not be a contest between interest groups, but an exercise in seeking to discover whether or not there exists a decision that better serves the long term interests of consumers).
- There should be a single ground for appeal, to the effect that there is reason to believe that a materially preferable decision exists (to reduce the influence that appellants have, at the beginning of the appeal stage, on the way that matters are subsequently examined, and hence to reduce ‘gaming’ risks).

The Panel is of the view that these recommendations will themselves go a long way toward eliminating the risk of excessive appeals activity (which tends to be stimulated by contests over the distribution of economic resources), but that further measures are warranted to ensure that policy objectives relating to the costs and timeliness of merits review are

achieved. The key feature to be sought in these ‘limiting’ measures is that they should not interfere with the ability of reviewers to explore any aspect of a decision that they consider to be potentially informative about the merits of the decision itself. Hence:

- The Panel recommends that the scale of review of activity be limited by measures such as (a) recourse to materiality thresholds (so that, for example, appeals will not be allowed if the costs of review appear disproportionate to the issues raised), (b) time limits for the conduct of reviews, and (c) requirements to adopt the ‘record’ of the primary decision maker as a starting point (so that, to the extent that reviewers collect and examine information, they do so incrementally, not on a *de novo* basis).

In the light of the increasing difficulties and uncertainties that were encountered in trying to think how the ACT might be reformed so as to be able to investigate any matter that is considered to be relevant to assessing the merits of a regulatory decision, the Panel has concluded that neither the ACT nor an alternative form of tribunal is the most appropriate vehicle for the conduct of merits review in ways that have the characteristics necessary to meet public policy objectives. In this, we find ourselves repeating the conclusions of the Administrative Review Council (ARC) in its 1999 publication ‘*What decisions should be subject to merits review?*’<sup>1</sup>, which, among other things, indicated that (tribunal-based) merits review is unlikely to be appropriate for major decisions that are made over an extended time period, involve an extensive inquiry and consultation process, have implications for a wide range of different interest groups and involve a significant degree of policymaking. We note that the entanglement with policy making creates severe difficulties for judge-led organisations, since it requires judges not only to become policymakers, but also to explain and be accountable for decisions in the way that a primary regulator is. The Panel has detected no great enthusiasm for this kind of ‘politicisation’ of the judiciary.

Precisely because of the high value placed on judicial independence from the executive arm of government, it appears to the Panel that what is meant by ‘merits review’ has been shaped into a form such that the ACT can undertake reviews without putting judicial independence at risk. Unfortunately, from a public policy perspective, this is to get things upside down: institutions should be developed to serve policy, not *vice versa*.

- The Panel therefore recommends that a new, wholly administrative, review body, provisionally labelled the Australian Energy Appeals Authority (AEAA), take over all, or the great bulk of, energy sector review work currently undertaken by the ACT, and in particular that the AEAA take over review of NSP revenue/price determinations.

It is an important feature of these recommendations that, although we expect the level of appeals activity to be reduced by them (because they will dampen the incentives toward

---

<sup>1</sup><http://www.arc.ag.gov.au/Publications/Reports/Pages/Downloads/Whatdecisionsshouldbesubjecttomeritreview1999.aspx>



excessive review activity arising from current constraints and limits placed on the process), it is necessary that more assessment resources be made available to handle individual cases than are currently available to the ACT. This is because, when an appeal is heard, the reviewers will, by design, have the capability to examine any issues that they consider relevant to the regulatory decision itself, and will not be restricted to issues that are linked with specific, often narrow, points raised as grounds for appeal.

Particularly given the intermittency of review activity, the Panel considers that it would be difficult to attract necessary support staff of sufficient quality, at least at reasonable cost, if the AEAA operated on a stand-alone basis.

- The Panel therefore recommends that the AEAA, whilst operating as an independent authority, be attached to an existing administrative agency, from which it can draw resources and administrative support (on a pay-for-service basis). In particular we recommend that the attachment be to the Australian Energy Market Commission (AEMC).

Apart from the existing concentration of energy market expertise at the AEMC, there are two further reasons why the Panel considers it to be an appropriate institutional host. First, as an agency governed by statute and responsible to multiple governments, the independence of the AEMC is underpinned by structural factors that may help give reassurance regarding the integrity of the review process. When a regulatory agency is accountable to only one government there tend to be fewer obstacles to that government taking back powers that it has previously delegated, as a quick glance at recent UK energy policy history will vividly illustrate. Second, there is functional similarity between the *ex ante* rule making of the AEMC and the proposed *ex post* assessments of the AEAA: each is directed at supervision of the decision making of primary regulators, and effective regulatory governance requires a degree of co-ordination and balance between these two forms of supervision.

- Whilst the Panel recommends (a) that the AEAA should conduct its affairs on a fully independent basis, (b) that the membership of the AEAA should not include AEMC Commissioners, and (c) that the only shared resources should be staff and administrative support, it also recommends that AEMC Commissioners and AEAA members should be required to meet from time to time, to consider developments in the National Electricity Rules (NER) and National Gas Rules (NGR), and to consider the issues raised in recent reviews, in order to avoid conflicts between the two, complementary modes of supervision.

In line with its terms of reference, the Panel has considered the relationship between its recommendations for the development of the merits review regime and the developments to rules currently under examination by the AEMC.

- We recommend that the Standing Council on Energy and Resources (SCER) asks the AEMC to undertake a review of the existing shape of the NER and NGR with a view to achieving greater consistency, including consistency in the use of language, with (a) the provisions of the National Electricity Law (NEL) and the National Gas Law (NGL), and (b) any changes to the merits review regime that are pursued consequent to this Report. In particular, we recommend that the NER and NGR are made clearer:
  - In distinguishing between regulatory decisions that have binding effect on other parties and what are, in reality, assessments that contribute to such decisions, which do not themselves have binding effects (some of which are misleadingly also referred to as ‘decisions’ in the rules).
  - In identifying that it is decisions with binding effects that should be the reviewable decisions.<sup>2</sup>
  - In reinforcing, in detail, those provisions of the NEL and NGL that specify the NEO, NGO and the revenue and pricing principles as the criteria to be used when the regulator is exercising discretionary power.
  - In indicating that the assessments of the revenues that are estimated to be required to cover costs or expenditures falling within an individual building block or within the components of a building block (such as operating expenditure (opex), capital expenditure (capex), depreciation, etc.) are exactly that, assessments to inform the regulator’s estimation of, and decision-making on, the total revenue requirement, not decisions that have binding force in and of themselves.

Regarding the last point, the Panel thinks it is misleading to call those assessments ‘constituent decisions’, since an assessment that a NSP will require \$500 million, say, to cover opex over a future regulatory period does not lead to a situation in which the NSP is constrained to spend \$500 million in opex, or is constrained to spend no more than \$500 million in opex, or is in any other way constrained in its opex spending. We are also of the view that the constituent decision terminology and the degree of prescription on those matters in the rules is one of the principal reasons for the prevailing (and in our opinion erroneous) view that the rules require the regulator to adopt a mechanistic, bottom up procedure in arriving at a preferred estimate of, and decision on, the total required revenue.

We have also taken the opportunity explicitly afforded in the Panel’s terms of reference to comment on a number of wider matters, which might affect the efficacy of the merits review process and of the operation of the regulatory system as a whole, whose individual

---

<sup>2</sup> Reviewable decisions are defined in the NEL and NGL in general terms, but there should be greater specificity in the rules.

components need to work together if satisfactory outcomes are to be obtained. Our main suggestions on these other areas are as follows:

- To promote increased attention on consumer preferences and requirements on the part of NSPs when developing business plans, and to reward independent, innovative initiatives to promote consumer welfare, the NER, NGR and the rules of operation of the AEAA should direct regulators and reviewers to take account of NSP efforts to understand consumer requirements and NSP initiatives to advance consumer welfare when assessing revenue allowance decisions.
- It would likely facilitate the development of more effective efficiency incentives for NSPs if the AER were independent of the Australian Competition and Consumer Commission (ACCC). The Panel heard a range of views to the effect that, as a constituent part of the ACCC, the AER Chair and members are constrained in their ability to independently direct the development and operations of the organisation. The issues range from practical matters to do with control over organisational strategy and appointment and direction of managers and staff, to the tensions that exist between the culture and processes required of an effective, contemporary regulator of public utility services (which has to be continuously engaged with consumers and NSPs) and the more arm's length culture appropriate to an enforcement agency such as the ACCC. The Panel is of the view that the recommendations it has made for the reform of the merits review regime, together with a pressing need for joint-working between the AER and NSPs to develop more effective incentive arrangements around capital expenditures, innovation and network pricing (so as to help mitigate upward pressures on network capital costs), serve to strengthen the case for establishing the AER as an independent agency, separate from the ACCC.
- The question of privatisation of publicly owned networks should be revisited. The Australian regulatory system, including the recommended developments of merits review proposed in this Report, can be expected to function more effectively with privately owned NSPs (the main features of the system having been originally designed for the regulation of privately owned monopolies). Among other things, privatisation would eliminate the almost inevitable conflicts that arise when management of publicly owned NSPs are, in effect, subject to simultaneous supervision by different public institutions – the economic regulator, the minister representing the shareholder interest, and possibly the relevant energy minister – each independently pursuing overlapping public policy objectives.
- There is scope for more sophisticated network pricing and developments in demand management, which have the potential to reduce future network capital expenditure requirements by large amounts. This should be a priority area for joint work by the AER and NSPs.

- Whilst the system of scrutiny of NSP costs is capable of further improvement, it is basically sound and in line with international best practice. In contrast, scrutiny of *ad hoc* public environmental expenditures and subsidies are, in Australia like just about everywhere else, undeveloped, with consequent risks of waste of resources on a grand scale. The Panel suggests that environmental policy should learn from utilities policy in the area of cost scrutiny, not least in relation to the value to be derived from the existence of an independent scrutineer, but notes the risk that, if this is not done, sound regulation of networks could become infected by less rigorous approaches, at great potential cost to consumers.

Returning to the more specific recommendations concerning the development of the merits review regime for electricity and gas networks, the Panel is cognisant of the need for investor confidence in independent and stable regulatory arrangements. 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 that 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 – which will pose great risk to regulatory certainty and investor confidence in the medium and longer terms.

## 2. BACKGROUND TO THE STAGE TWO REPORT

### 2.1 The Limited Merits Review Regime

In 2006, the MCE agreed to adopt a regime that allowed parties affected by a decision of the energy regulator, or other relevant decision maker under the NEL or the NGL, to have these decisions reviewed.<sup>3</sup> Following consultation processes designed at assessing the best option for the review regime, the LMR regime was introduced into the NEL on 1 January 2008 and into the NGL on 1 July 2008.

The LMR regime was intended to *'facilitate the correction of a range of regulatory errors with significant adverse consequences, encourage the making of the best administrative decisions in all circumstances and encourage investment in gas and electricity and across those sectors by promoting confidence in the regulatory process.'*

In considering options for the design of the review regime the MCE identified an objective of providing a regulatory framework that *'promotes the efficient investment in and use of energy infrastructure, such that economic regulatory decisions provide a balanced outcome between competing interests and protect the property rights of all stakeholders'*. In its Stage One Report, the Panel noted this is not quite the same formulation as that of the NEO and NGO, but that there is no necessary inconsistency between the two formulations provided that care is taken when interpreting the notion of 'balancing'.<sup>4</sup>

The MCE's consultation regulatory impact statement (RIS) canvassed a number of options for the review of regulatory decisions, including:

- continuing with the then *status quo*;
- relying on judicial review only;
- introducing full merits (*de novo*) review; or
- introducing a limited merits review regime.

After extensive consultation and discussion on the RIS, the MCE released its Decision Paper *Review of Decision-Making in the Gas and Electricity Regulatory Frameworks* in May 2006.<sup>5</sup> The Decision Paper set out the MCE's expectations regarding the benefits from

---

<sup>3</sup> Decisions subject to limited merits review are those specified in the NEL s71A and NGL s244, as described under the definition of "reviewable regulatory decision".

<sup>4</sup> For example, in practical terms, the major balancing issue in regulatory assessment tends to centre around ensuring that the interests of future generations of consumers are given sufficient weight. In contrast, in well specified regulatory systems and for reasons that are discussed later, there should be relatively little balancing to be done between the interests of NSPs and the interests of consumers. That is because, like all suppliers, NSPs exist to serve consumers, and good incentive structures will align NSP rewards with their success and failure in promoting consumer welfare (as happens in well functioning competitive markets) or, at a minimum, will at least avoid serious misalignments.

<sup>5</sup> Ministerial Council on Energy (2006) "Review of Decision-Making in the Gas and Electricity Regulatory

reviews of decision making in electricity and gas sectors and confirmed its policy preference for the LMR option over all other options. Following this decision, changes to the relevant legislative instruments were enacted and the LMR regime came into force.

## **2.2 Background to the Current Review**

The legislation for the LMR regime included a provision that a review of the effectiveness of the regime should occur within seven years of its commencement. It was anticipated that this review would ‘*assess how the review scheme has operated since commencement.*’

In December 2011 the SCER, the successor Council to the MCE, agreed that the Review of the LMR regime (the Review) should be brought forward, with the intention of it concluding by 30 September 2012. A terms of reference document was developed for the Review<sup>6</sup> and, on 7 March 2012, an expert panel (the Panel) was appointed and the Review formally commenced.

The Panel consists of Professor George Yarrow (Chair), Dr John Tamblyn and the Hon. Michael Egan. The Panel was supported throughout the Review by a Secretariat provided by the Commonwealth. The Secretariat’s functions were primarily administrative in scope, and included the provision of logistical support for consultations and some assistance in summarising submissions and other research.

The Panel was also greatly assisted by the work of Dr Chris Decker, Research Director at the Regulatory Policy Institute, Oxford, throughout the Review process. Dr Decker undertook extensive research on behalf of the Panel and provided assistance in drafting the Panel’s papers for the SCER Senior Committee of Officials (SCER SCO).

The Review was conducted under the auspices of the SCER. The Panel was independent from the SCER and was funded by a special account contributed to by all the SCER member jurisdictions.

This report is the Panel’s Stage Two Report under the terms of reference. It does not necessarily reflect the views of SCER or its officials.

## **2.3 Organisation of the Review of the LMR**

The terms of reference divided the Panel’s tasks into two stages:

- *Stage One.* An overview assessment of how the LMR regime has operated to date in both the electricity and gas sectors, and of the extent to which policy outcomes anticipated in the MCE Decision Paper have been achieved. The Panel was required

---

Frameworks”, Decision, May 2006.

<sup>6</sup> See Annex 4 for the terms of reference

to submit an interim Stage One Report to SCER SCO by 30 April 2012, with the final Stage One Report to be completed by 30 June 2012.

- *Stage Two.* To provide advice to the SCER about whether changes to the avenues for appeal available for network businesses are required to deliver an appropriate balance between the commercial needs of the businesses and efficient outcomes for consumers, consistent with the NEO and NGO. The Panel was required to submit an interim Stage Two Report to SCER SCO by 31 August 2012, with the final Stage Two Report to be completed by 30 September 2012.

### *Stage One*

Stage One assessed the performance of the LMR regime, and in particular, examined how the regime has operated to date in the electricity and gas sectors against the original policy intent of the MCE.

The Panel's Stage One Interim Report focused on providing the SCER SCO with a summary of the Panel's initial approach to its tasks. The Panel noted that it was focusing on two major tasks in Stage One:

- Developing an understanding of the history and performance of the LMR regime to date, and
- Developing an understanding of the policy objectives underlying the MCE's Decision, and of how the MCE anticipated that the LMR regime would work in contributing to these objectives.

To undertake the first of these tasks, the Panel noted that it was gathering evidence on, among other things:

- The chief characteristics of the cases that have come before the ACT to date,
- The structure of the LMR regime, with a view to assessing whether any inferences about incentives could be made from that structure,
- The conduct of the various parties who have been participants or potential participants in the LMR appeals process since its inception,
- The reasoning contained in the ACT's judgements,
- Some of the more important energy cases from the period before the LMR regime was introduced,
- Some of the more important appeals cases arising in other sectors, and
- Practice in comparator jurisdictions overseas.

In addition, in its Stage One Interim Report, the Panel made some limited, preliminary observations on the operation of the LMR regime over time from the evidence it had

collected. The Panel drew specific attention to two potential issues that were emerging from its research:

- The AER had not used its powers to widen issues in cases or raise additional matters (s71O(1) of the NEL and s258 of the NGL). The Panel noted that it was of the view that understanding the potential, and limitations, of the s71O(1) powers would be important in assessing arguments that the LMR regime necessarily leads to ‘cherry picking’ by applicants.
- There had been only limited participation of network users and consumers in the appeals process to date, suggesting there were issues and potential problems with the practicalities and abilities of network users and consumers to participate in the LMR regime.

The Panel provided its final Stage One Report to the SCER on 29 June 2012. The Panel’s high level assessment of the performance of the LMR regime was that, in its implementation, the regime had fallen short of the initial policy expectations in some important and key respects, and that there were a number of weaknesses and deficiencies associated with the regime.

Specifically, the Panel observed that the general approach to reviewing decisions under the LMR regime was unduly narrow and formalistic, and that the approach that had developed was relatively detached from the promotion of the objectives set out in the NEL and NGL, and particularly from the requirement that regulatory decisions be directed toward encouraging outcomes that are in the long term interests of consumers.

#### *The MCE Policy Intent*

In accordance with the terms of reference, Stage One of the Review focused on assessing the extent to which the outcomes of the LMR regime have been consistent with the policy objectives outlined in the MCE’s 2006 Decision Paper and in other documents of the time that cast further light on what the LMR regime was expected to achieve.

In ascertaining the policy intent of the regime, the Panel started with the NEO and the NGO, in which policy purposes are set out at their highest level. A number of points were noted, including:

- The AER, under the NEL and the NGL, must perform its economic regulatory function or power in a manner that is likely to contribute to the achievement of the relevant national energy objective<sup>7</sup>.
- When there are questions concerning the interpretation of provisions, “... *the interpretation that will best achieve the purpose or object of this Law is to be preferred to any other interpretation.*”<sup>8</sup> Immediately following the statement of the NEO/NGO,

---

<sup>7</sup> NEL s16(1). NGL s23.

<sup>8</sup> Schedule 2, Clause 7 of the NEL and NGL.



the NEL/NGL sets out a series of revenue and pricing principles. These are effectively matters that are considered important for the achievement of the NEO/NGO when the AER is making revenue/price control decisions, and which the AER must take into account in those decisions (though not necessarily in other types of decision).

- Since the AER is bound by the above aspects of the Law when making revenue and pricing determinations for network providers, the ACT, in ‘standing in the shoes’ of the AER, should be bound by the same clauses. (Subsequently, however, the Panel was informed that the notion that the ACT ‘stood in the shoes’ of the AER when conducting its reviews was a misleading one.)

In the specific context of considering the arrangements for a LMR regime for energy network decisions, the MCE set out a list of narrower goals as follows:

- Maximising accountability;
- Maximising regulatory certainty;
- Maximising the conditions for the decision-maker to make a correct initial decision;
- Achieving the best decisions possible;
- Ensuring that all stakeholders’ interests are taken into account, including those of service and network providers, and consumers;
- Minimising the risk of “gaming”; and
- Minimising time delays and cost.

In summary, the Panel inferred that the policy intent of the MCE in establishing the LMR regime was to develop a system that would achieve the best (most preferable) decisions possible from among those considered feasible, within a framework where the benefits of the review could be expected to outweigh the costs to stakeholders.

The Panel concluded that it was not the intention of the MCE to limit the scope of appeals to be considered by the ACT, but rather that it was intended that the time taken and costs incurred for appeals would be limited. This was indicated by the MCE’s 2006 Decision Paper, where the MCE first defined a merits review as “*involving consideration of more than just whether a decision contains an error of law. Generally merits review considers whether the decision under review is the “correct and preferable” decision.*”<sup>9</sup> Secondly, the paper adds that “*a merits review scheme with certain limitations was put forward by SCO for consultation with stakeholders, in order to balance the costs and delays involved in merits review...*”<sup>10</sup>

---

<sup>9</sup> Ministerial Council on Energy (2006) “Review of Decision-Making in the Gas and Electricity Regulatory Frameworks”, Decision, May 2006, page 10

<sup>10</sup> Ibid, page 10.

This conclusion was further supported by evidence in the MCE’s Decision Paper that includes reference to *broad “re-opener”* powers for the regulator<sup>11</sup>; the ability for interveners to be able to raise new grounds of review, such that the *review would not be limited to only those grounds that the network or service provider, or user and consumer group advance*<sup>12</sup>; and a *relatively wide scope for certain persons and user and consumer groups to intervene in proceedings, once commenced*.<sup>13</sup>

### *Stage One Findings*

Based on the Panel’s interpretation of the MCE’s policy intent for the appeal arrangements, the following deficiencies of the regime were identified:

- The arrangements have not ensured that all stakeholders’ interests have been adequately taken into account. Specifically, the long term interests of consumers have typically not been explicitly considered when review decisions have been made.
- Consumer bodies and network user associations (with justification) feel excluded from the appeals process, including, but not exclusively, for cost reasons.
- The regime lacks legitimacy with important stakeholder groups: trust and confidence in the AER and the ACT has not been established, and the AER itself does not appear to have any great confidence in the regime as currently constituted.
- The lack of legitimacy puts regulatory certainty at future risk, particularly if upward pricing pressure continues, driven by factors such as the increasing costs of environmental regulation.
- Doubts about the effectiveness of the regulatory arrangements have a basis in the facts that (a) some of the ACT’s decisions have had major implications for network charges and end consumer prices, (b) convincing and coherent accounts of how these decisions might have positive effects on the long term interests of consumers have been lacking, and (c), more generally, an informed consumer would find it very difficult to discover a credible account, from any authoritative source, of why energy prices are changing as they are.
- The measures introduced to mitigate the risk of appeals becoming too narrowly focused, most particularly s71O(1) of the NEL and s258 of the NGL, have not been utilised to any significant extent.
- The LMR regime has been costlier to operate and cases have taken longer than was anticipated.

The Panel’s terms of reference required, among other things, a quantification of the impacts of outcomes from appeals of regulatory decisions to the ACT. Various estimates were

---

<sup>11</sup> Ibid, page 20.

<sup>12</sup> Ibid, page 5.

<sup>13</sup> Ibid, page 17.

presented in the Stage One Report of the immediate impact effects of ACT decisions relating to the cost of capital and related issues. These figures were supplied by Professor Allan Fels on behalf of the Energy Networks Association (ENA), Ernst and Young on behalf of the APA Group and Carbon Market Economics on behalf of the Energy Users Association of Australia. Taken together, these estimates suggested that the immediate impact of ACT reviews of the relevant AER determinations of revenue allowances resulted in an upward impact on overall NSP revenues of over \$3 billion.

While the Panel did not endorse any one particular estimate of impacts, it did draw the conclusion that the effects of ACT revisions to AER determinations were matters of some consequence for network users, end consumers and owners of NSPs, and that the short-term impacts are sufficient to indicate the significance of the LMR regime for achievement of the NEO and NGO. More generally, the Panel observed that such estimates did not measure the ultimate, long term effects of the ACT decisions on consumers, which, given the NEO and NGO, are things that it would be desirable to measure. The fact that the Panel was unable to form a view of the implications of the ACT decisions for the long term interests of consumers was interpreted as indicative of a central performance weakness of the LMR regime to date: despite the centrality of their interests to the NEO and NGO, the implications of the decisions for consumers had not figured as a central issue in the review process.

The Panel was also asked to consider other appeal processes within Australia and internationally, for comparison purposes. The Stage One Report noted that (a) for major regulatory decisions such as price or revenue control determinations, some or other form of merits/administrative review was a common feature of regulatory systems, and (b) the comparisons indicated considerable diversity in institutional arrangements.

On the basis of the points above and other evidence set out in the Stage One Report, the Panel had no hesitation in concluding that there has been considerable divergence between outcomes and the policy intentions that had motivated the development of the LMR regime.

### *Stage Two*

Having compared actual outcomes with anticipated outcomes, Stage Two of the Panel's task focused on providing advice to the SCER on whether any changes to the LMR regime appear desirable in the light of past performance and the regime's contribution to over-arching policy objectives. Under the terms of reference for the Review, this advice is to include consideration of amendments to the LMR regime, to other aspects of the NEL and the NGL and to the NER and NGR. The Panel was also asked to consider the costs and benefits associated with its recommendations, in line with the NEO, the NGO and the revenue and pricing principles. Finally, the terms of reference invited the Panel to comment on any other factors that might be relevant to the operation of the review regime.

In conducting Stage Two of the Review, the Panel focused on identifying the significance and desirability of a number of characteristics of a review regime, and on the inherent trade-offs between these characteristics. The Panel's recommendations have been developed

around consideration of combinations of those characteristics that are most likely to contribute to the achievement of the MCE's initial policy intent.

The Panel submitted its Stage Two Interim Report to the SCER SCO on 31 August 2012. This report provided a summary of the Panel's findings up to that date and gave an indication of the directional thinking of the Panel in developing its recommendations.

In the interim report, the Panel noted that it had been examining in more detail the desirable characteristics of the review regime, informed by the weaknesses of the current arrangements identified in Stage One. These desirable characteristics included the requirements that a review process should:

- Be capable of addressing issues on a sufficiently wide basis, up to and including the overall price/revenue determinations themselves, to capture all relevant inter-relationships among the individual aspects of decisions;
- Explicitly take account of and promote the NEO and NGO, since these are the objectives against which the question of whether or not there exists a decision that is preferable to the decision of the primary decision maker (which is a key feature of merits review) should be evaluated;
- Promote consumer and user access to the relevant decision making processes, including the review process itself, and promote NSP engagement with consumer requirements at all stages of regulatory decision making; and
- Not be more protracted or more demanding of resources than is necessary to achieve the fundamental purposes of merits review.

Given these points, the Panel indicated that, prompted by the discovery of potential obstacles to reform of the existing, tribunal-based structure, it was looking at alternative institutional arrangements which might be capable of sustaining ways of meeting these requirements. As noted, these obstacles were first signalled toward the end of Stage One of the Review, but as the Panel's explorations continued, they appeared to give rise to an expanding cloud of difficulties and uncertainties.

Specifically, the Panel noted that it was considering the following in relation to its final recommendations:

- Whether a stand-alone review body specialised in the review of energy network decisions could be viable, and, if not, how a fully administrative review body might be attached to an existing administrative agency, so as to economise on what are, in practice, scarce assessment resources;
- The suitable, alternative possible 'attachments' for such a body within the existing institutional architecture, of which the AEMC and ACCC were the most obvious options;

- How the costs of review should be funded; and
- How discretion might be afforded to the review body to limit the scope of its own activities in an individual case where, in the light of the NEO and NGO, and of the anticipated costs of review, it appeared appropriate to do so.

## **2.4 Consultation**

The Panel was greatly assisted in its tasks by the contributions of those parties who participated in the consultation process, whether by providing written submissions and reports, or via meetings with the Panel, or both. The interchanges were constructive throughout, and we were particularly impressed with the submissions of some of the smaller participating organisations, which had a succinctness and directness that made them a pleasure to read. A list of submissions received by the Panel is set out in Annex 5.

In order to provide an initial, organising framework for consultation for Stage One of the Review, the Panel published two ‘statements of issues’ or consultation papers on 30 March 2012 and 27 April 2012 respectively. These papers set out matters on which the Panel sought stakeholders’ views.

To guide consultation for Stage Two of the Review, on 24 July 2012 the Panel released a short Discussion Paper. This paper set out the approach the Panel would take to guide it through its Stage Two deliberations and identified a number of issues on which the Panel sought stakeholders’ views.

In addition, the Panel held two public forums. The public forum for Stage One of the Review was held on 9 May 2012, and the public forum for Stage Two was held on 30 July 2012. A list of organisations that attended these forums is at Annex 6.

The Panel’s consultation papers, discussion paper, Stage One reports, Stage Two Interim Report and all stakeholder submissions the Panel received are available from: <http://www.scer.gov.au/workstreams/energy-market-reform/limited-merits-review/>.

### **3. THE PANEL'S APPROACH IN STAGE TWO**

#### **3.1 The Panel's terms of reference and the breadth of its work**

The focus of the Review is on the LMR regime, but it is not possible to do this without examining the regime in the wider regulatory and policy context, since the various constituent elements of the energy policy regime as a whole must work together for maximum effectiveness.

In particular, it was noted in the Stage Two Interim Report that, in contemplating how the LMR regime might function in the future, it was inappropriate to assume that all other aspects of energy policy arrangements would be unchanging. This Review is only one strand of a wider set of policy changes that are currently under contemplation, such as the rule change proposals that have been considered by the AEMC at the same time as the Panel has been undertaking its review.

These points were embodied in the terms of reference for Stage Two of the Review, which both draw attention to the AEMC process and are permissive in relation to the Panel's ability to consider, and to make recommendations about, other relevant matters, such as factors that might be expected to exhibit significant interdependencies with the LMR regime. Thus, the terms of reference state that:

*In undertaking Stage Two of the Review the consultant is required to provide a Final Report, including:*

- 1. In light of findings from Stage One, including the materiality and treatment of interested parties, recommendations on the next steps for the SCER. This should include consideration of, but not be limited to (emphasis added):*
  - a. amendments to the limited merits review regime;*
  - b. amendments to other aspects of the NEL and NGL;*
  - c. changes to the National Electricity Rules and National Gas Rules; and*
  - d. the costs and benefits associated with the recommendations, in line with the NEO, NGO and revenue and pricing principles.*

Whilst maintaining a strong focus on the features of the LMR regime itself, and on its interdependencies with the NEL, NGL, NER and NGR, the Panel has, therefore, also gone on to assess, and to make comments on and recommendations about, other, related aspects of energy policy (see, in particular, section 6 below).

### **3.2 A central puzzle: a merits review regime that has not encompassed review of the merits of the principal decisions**

The Panel has wrestled with one particular issue throughout its deliberations. On the face of things, the policy intent set down in MCE documents at the development stage of the LMR regime was clear, and it is possible to see obvious connections between that policy intent and the relevant provisions in the NEL and NGL. In particular, in relation to revenue/price control decisions by the AER, and as noted in the Stage One Report, MCE documents indicate an intention “*to allow the original decision to be considered holistically*”. A number of submissions and expert reports have suggested that this capacity (where appropriate, to consider decisions holistically) has indeed been available throughout, in consequence of the AER’s s71O(1) NEL and s258 NGL powers.

In practice, however, it has not been the case that reviews have shown any tendency to assess relevant decisions in this way, and the Panel has not been provided with any convincing account of why there has been such a gap between intentions and claimed possibilities on the one hand, and actual outcomes on the other hand. The Panel has therefore sought to develop its own understanding of the position, and has come to the view that a number of factors may have combined and interacted in ways that have thwarted the policy intent.

Whatever the precise conjunction of these confounding factors, as things stand it appears not to be possible for the AER to determine how wide a review can go, since the ACT itself appears to be constrained in what it can consider (see section 4 below). Initially, the Panel thought that the problem might simply be an unwillingness of the AER to use its powers under the legislation, but, in the light of the evidence that has accumulated since the start of this Review, it has concluded that the barriers to widening the scope of reviews are more complex than that.

### **3.3 Importance of relative certainty about outcomes**

The failure of the LMR regime to date in the face of clear policy intentions, coupled with the increasing pressures on energy policy institutions as a whole arising from upward cost pressures, particularly in the electricity sector, suggests that, in evaluating potential reforms, it is appropriate to give a relatively high weight to relative certainty of outcome. There are already risks to the legitimacy not only of the LMR regime itself, but also to wider regulatory and energy policy arrangements, arising from these factors (perceived past deficiencies, upward cost and price pressures). To fail to address the underlying issues could, at least in relation to the price control matters that are of the greatest consequence for legitimacy and stability, lead to further, substantial increases in those risks. It should go without saying that erosion of the legitimacy and general acceptability of regulatory institutions and processes could be highly damaging for the effectiveness of public policy in the energy sector.

On this basis, the Panel has attached particular significance to certainty in addressing two, central matters identified in Stage One, namely that:

- Merits review should be capable of directly addressing the central decision of interest, namely the overall revenue/price determinations made by the AER, not just constituent elements or parts of those determinations.
- Consumer and user representatives, as well as other interested parties, should be able to have easy and equitable access to the merits review process.

### **3.4 The July Discussion Paper: identifying salient characteristics of review regimes**

In the July Discussion Paper the Panel identified a number of high level attributes or characteristics of review regimes, which, in various combinations, determine the general shape of a regime. The aim of this approach was to seek greater clarity on what combinations of characteristics might be the most effective in meeting the original policy goals set out by the MCE, and in particular in achieving the merits review that was sought, but without incurring substantial costs and delays in doing so.

Among the characteristics identified were the following:

- The scope of the decisions to be reviewed. For example, whether the review is limited to specific grounds of appeal, and to issues closely connected with those grounds of appeal, or whether it should encompass the principal decision actually made, namely the overall revenue determination.
- Whether, when allowing an appeal, the review body is capable of substituting its own decision for that of the primary decision maker, or whether a successful appeal should always end with remittal of the matter back to the primary decision maker. Merits review normally involves the possibility of substitution, though it does not normally require it, whereas judicial review works on a remittal-only basis.
- The resources available to the review body for assessment purposes, a matter that is clearly linked to the scale and scope of the reviews.
- The time constraints on reviews, which provide one means of limiting the scale and scope of the review.
- Whether the review body is part of the same organisation as the primary decision maker, as it tends to be in the US, or is organisationally separated, as it currently is in Australia and the UK.



- The nature and processes of the review body, including the issues of the degree to which proceedings are court-like, in the sense of being both adversarial and formal in nature, or are more investigative and informal.
- The composition of review panels, including issues of size and of appropriate qualifications of members and chairs.
- The extent of consumer engagement in the review process.
- The appropriate margin of appreciation or discretion that reviewers should accord to the primary decision maker. Generally speaking, merits review operates with a lower margin of appreciation (lower degree of deference to the primary decision maker) than judicial review, but the lower the margin the closer review tends to be to a *de novo* assessment, and the higher tend to be the costs of review.
- The extent to which the structure of the review regime includes incentives for parties themselves to agree on some or all issues.

### **3.5 Issues of institutional structure**

The approach adopted carries the implication that it was only after consideration of the above characteristics, and of any other attributes that emerged during the consultation process, that the Panel came to consider the most appropriate institutional form for a review body.

The attributes most closely connected with the institutional question are those relating to the nature and processes of the review body that are best suited to serving the relevant policy objectives, but, even here, the linkages are not rigid. Whilst formal, adversarial proceedings might suggest more court-like arrangements, administrative review bodies can conduct themselves in more or less formal and more or less adversarial ways (e.g. in the latter case, by holding open hearings in which different parties can participate). Similarly, courts and court-like tribunals have sometimes made significant efforts to reduce formality and adversarial, legal jousting, although we have been told that, at least in respect of the consideration of more complex matters, the efforts have been difficult to sustain, and the tendency is for relapse to formality and adversarial contest, perhaps reflecting the strength of prevailing legal cultures.

In addition, therefore, to considering issues associated with the statutory LMR framework, the Panel has also given considerable thought in its Stage Two deliberations to how such a framework might best be implemented, and more specifically, to those attributes of a review body which are likely to facilitate the effective implementation of a review regime that can and does address the overall merits of decisions that affect the long-term interests of consumers.

## 4. DISCUSSION OF ISSUES RAISED IN THE STAGE TWO PROCESS

A range of significant issues has been raised and discussed during the course of the Review of the LMR regime, and this section of the Report sets out a few of the more important ones. The aim is to clarify what may be potential misunderstandings about the nature of some of the underlying issues, and to provide initial commentary on material that has informed the development of the Panel’s conclusions and recommendations.

### 4.1 The nature of merits review

A distinctive characteristic of the notion of ‘merits review’ as developed in the Australian context is that it applies a standard of review that is based on the ‘correct or preferable’ formulation; that is, whether the decision made by the original decision maker was the correct or preferable one. This distinguishes the merits review task – which has been described as focussing on the exercise of discretion by an administrative agency in ways that are non-justiciable<sup>14</sup> – from that of processes that examine the legality of administrative decision making.

An issue that immediately arises in relation to merits review concerns the distinction between when a decision should be held to be ‘correct’ and when it should be held to be ‘preferable’. On this point there seems to be some degree of consensus that ‘correct’ is the applicable standard in situations where there is only one acceptable decision, while the ‘preferable’ standard refers to situations where there is more than one acceptable decision.<sup>15</sup> For example, speaking of the role of administrative tribunals, Justice Garry Downes, President of the Administrative Appeal Tribunal (AAT), has succinctly summarised the purposes of merits reviews as follows:

*They reconsider the decision under review and determine whether it is the correct or preferable decision. Correct, when there is only one decision; preferable, when a range of decisions is available.*<sup>16</sup>

---

<sup>14</sup> The 1971 Kerr Committee report noted that: “the vast majority of administrative decisions involve the exercise of a discretion by reference to criteria which do not give rise to a justiciable issue. It follows that for constitutional reasons there can be no review by a court on the merits of these decisions unless those criteria are changed appropriately so as to raise justiciable issues”. Report of the Commonwealth Administrative Committee (Kerr Committee Report) (1971), Parliamentary Paper No 144 of 1971, para 68. See also Cane P (2009) *Administrative Tribunals and Adjudication* (Hart Publishing Oxford) page 146.

<sup>15</sup> Cane, *Ibid*, page 149.

<sup>16</sup> Downes G (2005) “Address to the Forum of Commonwealth Agencies Network”, 15 September 2005, page 2.

Given this general characterisation of merits review, and given their support for a merits review process (as compared to one based on judicial review), the Panel found it surprising that, in the course of the Review's consultation, many NSPs appeared resistant to the notion that what should be reviewed on its merits, in the sense of assessing whether or not it was the preferable decision when a range of decisions was available, was the principal decision in price/revenue review cases, namely the determination of an NSP's overall revenue allowance. Indeed the logic of the relevant NSP submissions seems to point toward a form of enhanced judicial review, in that what it implies should be assessed is the *process* of arriving at an overall determination, via its constituent assessments and the revenue and pricing principles that must be taken into account along the way, rather than the *substance* of the decision itself. In the Panel's view, this is not merits review in any normal sense (see the discussion above). Moreover, if the question to be settled is one of whether, in making the decision, the AER has not proceeded in accord with the NER or NGR (which have the status of law under the Australian arrangements), or with the pricing principles, these would appear to be matters that could be settled by judicial review, as advocated by some of the consumer bodies.

The Panel's interpretation of merits review – that it implies reconsideration of the AER's overall revenue/price determination to assess whether or not it was the preferable decision – seems to us to be consistent with the original policy intent, as indicated by references in MCE documents to the promotion of preferable decisions as a relevant policy goal, and also to the desirability of having a review regime that is capable of addressing revenue/price determinations holistically.

#### **4.2 The relevant context: price/revenue determinations**

The problems in the LMR regime identified in Stage One of the Review are principally to do with the review of revenue/price determination decisions of the AER, and not with other types of decision in the energy sector that are also subject to review by the ACT (such as decisions of the Minister relating to coverage of particular pipelines in gas, or decisions of the National Competition Council (NCC) on the form of regulation to be applied).

Generally speaking, revenue/price determinations are complex in the sense that they depend upon the processing of large amounts of information, rather than in the sense of requiring complex economics. There can be some economic complexity in developing the incentive aspects of regulatory determinations, and that complexity could increase if the Panel's later suggestions concerning the priority that should be given to the development of network charging structures are taken up, but the principal issues are more to do with cost assessments. Such assessments require engineering and project management knowledge and know-how just as much, if not more, than economic and legal expertise.

Regulatory experience suggests that it is generally not sufficient to 'buy in' all requirements for such expertise on an *ad hoc* basis, for example by subcontracting to consultants. Whilst

subcontracting can be used for significant parts of the assessment programme, it is desirable that such inputs be procured by knowledgeable, expert ‘buyers’, who can frame the appropriate questions and evaluate the results, and that the outputs from sub-contracted work are appropriately integrated with the tasks being undertaken ‘in house’.

In the Australian system, which requires the regulator to evaluate the proposals of NSPs, auditing skills are also of some significance at the primary decision stage, and in all jurisdictions such skills are of particular significance at the review stage. Auditing is explicitly aimed at testing out the reliability and validity of information, and of how information is handled within the relevant organisational or decision making process, and these are exercises that are increasingly integral to regulatory evaluations.

The relevant skills are particularly apposite in the current context, given that it is an objective of policy to place limits on the scale of activity at the review stage. Time and resource constraints are a normal feature of the audit function, and are addressed by techniques such as sampling, and by setting standards that are realistic in terms of the resources that will be available for the task. Thus, the standard required may be to seek *reasonable* assurance that a process is free of *material* errors, not that a decision making process is free of all errors.

In the course of the Review, it has become clear to the Panel that its desire to explore a merits review process that addresses a revenue/price determination as whole has been interpreted by some parties as a search for a form of *de novo* review. That is wrong, at least in terms of the normal sense of *de novo* meaning ‘starting again, from scratch’. The Panel has taken policy objectives as given, and it was manifestly one of the MCE’s aims to seek to avoid the costs and delay of *de novo* reviews, and to avoid the risk that the availability of such review would, over time, turn it into the primary decision making process. The perception may also reflect a misunderstanding of the nature of merits review *for the relevant types of regulatory decision*.

The standard is not perfection in decision-making: the aim is *improvement*, and specifically to consider whether there is a materially preferable decision. To be effective, the review body does not need to replicate the original decision process: it can sample, and borrow other auditing techniques as part of its process. However, in the Panel’s view, the review body does need to have the discretion to examine any aspect of the decision that it considers would be informative as to the quality of the decision as a whole. In short, there shouldn’t be ‘no-go’ areas for investigators.

### **4.3 The relevant objectives**

The NEO and NGO set out the high level public policy objectives, and are supplemented by the revenue and pricing principles which specify matters that the AER must take into account in revenue/price determinations (though not in all its decisions), and there has been some discussion during the course of the review as to how these should be interpreted.

One view put forward is that the NEO and NGO are focused on the promotion of economic efficiency, and that the reference to the long-term interests of consumers simply indicates that the expected effect of promoting efficiency is that it will simultaneously promote the long-term interests of consumers. The Panel has rejected this view because there are multiple definitions of the concept of efficiency and, at least in relation to the definitions and measurements usually adopted for practical policymaking purposes; it is not the case that higher efficiency *necessarily* promotes the long-term interests of consumers.

The simplest illustration of the point is the economic textbook result that a monopolist that practices perfect, or near perfect, price discrimination produces outcomes that are more efficient than those of non-discriminating monopoly, but which are much less favourable to consumers' interests, in the long-term as well as the short-term. More total 'economic benefit' is created by the efficiency of price discrimination, but it is all captured by owners, and consumers derive little or no benefit from trading in the relevant market. This is clearly not what public policy has in mind: in general, regulation of monopoly seeks to compensate for imbalances of power within a market, not to exacerbate those imbalances (whether under the sheep's clothing of 'promoting efficiency' or otherwise). Just as effective competition has been defined as 'competition that works well for the long-term interests of consumers', so effective regulation can be defined as 'regulation that works well for the long-term interests of consumers'. In both cases, there is an intentional, *distributional* tilt in public policy.<sup>17</sup> This distributional tilt is common to competition and regulatory policies around the world.

In the Panel's view, the NEO and NGO are well crafted, and are at the cutting edge of international best practice. Unlike in some other jurisdictions, the delegated or devolved regulatory objective is not simply to promote or protect the long-term interests of consumers, which would tend to make the relevant regulatory organisations consumer watchdogs or champions. The principal risk with this alternative approach is politicisation of the regulatory process, usually arising from *excessive* weight being given to the interests of today's consumers at the expense of future consumers. The NEO and NGO mitigate this risk in two ways: (a) by limiting delegated/devolved activities to one, relatively technical set of means of promoting the long-term interests of consumers, namely promoting improvements in the dimensions of efficiency identified (investment, operations, network use), and (b) putting investment efficiency at the front of the short list of means. The first of these limits

---

<sup>17</sup> This does not, of course, mean that suppliers are precluded from making reasonable profits, or indeed supernormally high profits in either system. The point is simply that, in both cases (effective competition, effective regulation), suppliers earn those profits by serving customers/consumers, and the level of profit is geared to the extent to which consumer welfare is improved. Moreover, such gearing of rewards to consumer welfare tends to attract greater general legitimacy, and hence tends to facilitate greater regulatory certainty, than do arrangements that lead to high supplier profits being achieved by ripping-off consumers, say, or by other means that are perceived as adding little or no value for members of society other than the relevant suppliers themselves.

the scope of legitimate regulatory decisions<sup>18</sup>, the second gives emphasis to the requirements of future generations of consumers. However, given the aforementioned lack of any rigid relationships between means (efficiency) and ends (long-term interests of consumers), it seems clear to the Panel that the long-term interests of consumers is the relevant criterion when deciding among different courses of action within the legitimate scope of delegated powers. Otherwise the NEO and NGO would provide no guidance to regulators as to how to proceed when there is a choice between alternative, ‘efficient’ (however that word is defined) prospects.

Another, related argument that has been put forward during the course of the Panel’s Review of the LMR regime is that the relevant objectives of the AER in revenue determinations are given by the revenue and pricing principles of the NEL and NGL, not by the NEO and NGO. Supporting reasoning here has been based on the point that the principles are more specific than the NEO and NGO, and that more specific legal provisions should displace more general text when there is an issue of which to follow.

The Panel has not found this reasoning at all convincing. The relevant section of the NEL, with our emphasis, is as follows:

*(1) The AER must, in performing or exercising an AER economic regulatory function or power—*

*(a) perform or exercise that function or power in a manner that will or is likely to contribute to the achievement of the national electricity objective; and*

*(b) ...*

*(2) In addition, the AER—*

*(a) must take into account the revenue and pricing principles—*

*(i) when exercising a discretion in making those parts of a distribution determination or transmission determination relating to direct control network services; or*

*(ii) when making an access determination relating to a rate or charge for an electricity network service; and*

*(b) may take into account the revenue and pricing principles when performing or exercising any other AER economic function or power, if the AER considers it appropriate to do so.*

---

<sup>18</sup> For example, a regulator cannot lawfully reduce prices, in order to win favourable media coverage say, on the sole ground that lower prices would make consumers better off: the NEO and NGO place obstacles in the way of such obvious misuse of power.

It seems clear to the Panel that, whilst the revenue and pricing principles must be taken into account, and whilst the principles are certainly intended to constrain the discretion of the primary decision maker, it is nevertheless the case that significant discretion remains. The language itself ('taken into account') implies recognition of the practical reality that a range of different decisions could be compatible with these principles. The criterion for choosing the most preferable of such decisions is not specified in the revenue and pricing principles themselves, but rather in the NEO and NGO, namely 'the long-term interests of consumers'.

#### **4.4 Requirement for review of substantive content of discretionary decision making**

The principal decision taken by the primary regulator in revenue determinations concerns the overall revenue that will be allowed to cover forecast/anticipated, efficiently incurred costs. Other decisions concern matters such as supplementary incentive arrangements, cost pass-through provisions, and so on.

The NER and NGR introduce the notion of constituent decisions, relating to particular, defined building blocks and to sub-components of those building blocks. These 'decisions' do not, however, translate into revenues that are allowable only for a specific purpose (i.e. revenues that are hypothecated). That is, the regulator in taking the final decision does not determine or approve a NSP's budgets for opex, capex, cost of capital, etc., which then each constrain spending in a particular area, but rather it determines an aggregate, allowable revenue. And, of course, it is that aggregate level of revenue that matters to customers and consumers, from whom it will be obtained. Put another way, the structuring of the rules around building blocks specifies an *assessment process* that leads ultimately to a single decision (the *overall price/revenue determination*).

Notwithstanding that the Australian system constrains the discretion of the primary regulator to a greater degree than is typically the case in other jurisdictions, it remains the case that considerable discretion remains at all stages and levels of assessment and decision. For example, the regulatory regime is based on forward looking assessments of costs, otherwise known as forecasts, which necessarily involve the application of judgment, an unavoidable level of subjectivity and, inevitably, (forecasting) errors. It would be feasible to write *ex ante* rules specifying precisely how the regulator should go about its cost forecasting, but it would be an extremely foolish thing to try to do. Sensibly, the NER and NGR do not do that: it is left to the regulator to decide such matters.

The Panel has been clear from the outset that, based on its own members' experiences, a primary regulator can, in a particular factual context, usually satisfy a given set of rules and principles in myriad different ways, not all of which lead to closely similar outcomes in terms of the final, aggregate revenue determination. Over the course of the Review, similar views have been expressed by a number of people with primary regulatory decision making experience who have given evidence to the Panel, and no substantiated case to the contrary

has been argued. If, therefore, the purpose of merits review is to help find the most preferable of these myriad, possible decisions, it must be capable of addressing the overall revenue/price determination itself, and the use of the discretion that has led to the actual decision made.

To try to set up merits review in some other way is, in our view, to fly in the face of regulatory realities that are common knowledge to those with extensive experience of the relevant processes, and abundantly documented in the economics of regulation. Thus, leaving aside normative issues – what regulators should do – the principal economic work on how regulation works in practice places its attention not on the propensity of regulators to make ‘errors’ – which, even if numerous, may, if they are random, have little effect on overall assessments one way or another – but rather on the susceptibility of regulators to be unduly influenced, on a systematic basis, by factors that are not part of their formal, ‘public interest’ agenda. Such effects include capture by the businesses subject to regulation, political influences driven by the issues of the day, zealots who have very specific theories of the world, and so on. Nowadays, this extensive body of economic work has been supplemented with an equally impressive and growing psychological literature on biases in individual and organisational judgments. Good regulatory systems, including good review arrangements, are designed to mitigate these unwanted influences.

#### **4.5 Separation of rule-making and enforcement**

A further aspect of policy, on which the Panel thinks there may be some misunderstanding concerns the separation of rule-making from rule-enforcement in the Australian regulatory system. This is significant because it has been submitted that, in effect, the need to maintain such separation should be treated as a constraint on what the Panel recommends. It may, therefore, be helpful to clarify matters a little, before the issue is addressed later below.

The NER and NGR are labelled ‘rules’, and they satisfy standard dictionary definitions of the word ‘rules’, but this should not be allowed to obscure the fact that those ‘rules’ that are directed at the way in which primary regulators make revenue determinations are qualitatively different from the kind of rules that apply, say, in relation to conduct in the wholesale electricity market, or in relation to use of transmission and distribution systems. The latter are applicable to a range of parties, typically with different interests, and enforcement involves policing activity.

Primary regulators such as the AER do not, however, *enforce* the rules that govern their own conduct in relation to revenue determinations; rather they *comply* with these rules. The NER and NGR have force of law, and infringements of the law are normally addressed via the courts. As we understand it, this is part of the basis of the argument that has been put to the Panel by those who believe that judicial review is a sufficient (and ‘separated’) mechanism for ensuring compliance.



Merits review does not, or at least need not, interfere with this basic structure. As indicated, its function is to promote preferable decisions, which is different from the function of ensuring compliance with a set of rules. In the context of revenue determinations, its chief, additive contribution is to allow for review of the discretionary judgements and decisions of the regulator, at a level of detail that courts are unwilling (and unable) to undertake. That is, merits review adds in a layer of supervision, targeted at the exercise of discretion.

This additional supervision can be, and under the current arrangements is, bundled together with adjudication in relation to a regulator's compliance with the rules. That is, the ACT deals with both types of issue. The arguments for such bundling are to do with effectiveness and efficiency, but the current arrangements do introduce some fuzziness into the division of labour and separation of powers among institutions, since they involve what is formally an administrative institution, the ACT, performing functions that are already provided for under judicial review.

The NER, NGR and revenue and pricing principles of the NEL and NGL are, in functional terms and insofar as they are directed at primary decision makers, aimed at supervising the activities of regulators by limiting and guiding the exercise of their discretion, via *ex ante* constraints on conduct. *Ex post* review is, in functional terms, also directed toward supervising the discretionary choices of the relevant administrative agencies.

Outcomes (final regulatory decisions) can therefore be viewed as being jointly determined by a combination of *ex ante* rules, discretionary choices of the primary decision maker, and, in some cases, *ex post* merits review (or, more generally, the threat of *ex post* merits review). Under current arrangements, each of these 'inputs' is provided by a separate institution: the AEMC, the primary decision maker (either the AER or Western Australia Economic Regulation Authority (ERA)), and the ACT. The first two of these types of body are directed by the law to make their decisions on the basis of the NEO, NGO and revenue and pricing principles, and therefore share common objectives. The Panel has found, however, that there are differences of view as to what it is that drives the ACT, an issue taken up more fully in section 4.7 below.

#### **4.6 Grounds for appeal**

A final issue that has arisen in the course of the Stage Two process and that the Panel considers to merit preliminary discussion here concerns the grounds for appeal, and whether there should be any amendment to the grounds currently set out in the NEL and NGL.

Under the relevant legislation, the current grounds of appeal are

- (a) the AER made an error of fact in its findings of facts, and that error of fact was material to the making of the decision;

(b) the AER made more than one error of fact in its findings of facts, and that those errors of fact, in combination, were material to the making of the decision;

(c) the exercise of the AER's discretion was incorrect, having regard to all the circumstances;

(d) the AER's decision was unreasonable, having regard to all the circumstances.

In its submission, the AER has suggested that ground (d) be removed, on the argument that the unreasonable ground of review is too wide and has provided a platform for applicants to dispute what should be the preferred reasoning in a regulatory determination. In the AER's view, ground (d) should be replaced with a ground of review that better captures the notion that 'the decision was not made in accordance with the law or the rules'

The ENA has defended the retention of the unreasonableness ground of appeal on the argument that, in its opinion, it is difficult to see how a decision that is unreasonable can in any way be consistent with the revenue and pricing principles or contribute to the achievement of the NEO/NGO. On this matter, the Panel finds the ENA position more in accord with its own views on the purposes of merits review: a decision can be made in accordance with the law and the rules yet still not be the preferred decision, and it is to provide a corrective in such a situation – which evidence on the economic effects of regulation suggests would be common in the absence of checks and balances – that merits review has been developed. Seriously flawed reasoning seems to the Panel to be a factor that can give rise to doubts about the merits of the decision, sufficient to warrant further investigation of that decision.

However, of greater concern to the Panel during the course of its Review of the LMR regime has been the view that, if errors are corrected, this will necessarily lead to a preferable outcome. Whilst this argument might have at least some force if errors to be corrected were selected at random, that does not correspond to the factual situation. Interested parties can choose their grounds of appeal, and this leads to bias in which particular errors are corrected. Thus, by way of illustration of the general point, if errors leading to a higher determination of revenue are approximately balanced by errors leading to a lower determination of revenue, then the correction of errors on only one side of the divide would actually create bias in what had previously been a near-unbiased assessment.

This is the 'cherry picking' point that has been made by critics of the existing arrangements and, whilst the Panel has not been in a position to conclude whether, in the relevant factual circumstances a significant bias has actually eventuated, it did conclude in Stage One that the LMR regime, as currently constituted, is vulnerable to this effect. Our Stage Two investigations, from which we have learnt in more detail about the constraints on the ability of the ACT to address matters that, although relevant to the overall revenue/price determination, might be somewhat remote from the grounds for appeal, have strengthened us in that view.

The significant amounts of revenue potentially available from successful appeal can make it attractive to bring cases in circumstances where there is no significant benefit in terms of the underlying policy objectives. Put simply, if appellants can pick their grounds for appeal, and if subsequent review is restricted in the extent to which it can consider matters other than those related to the chosen grounds of appeal, it can be expected that, from the perspective of promoting economic efficiency in the long-term interests of consumers, there will be excessive levels of appeal activity. Whilst the available evidence on the performance of the LMR regime is not decisive in demonstrating that this been a major problem to date, that is largely because the overall merits of the relevant decisions were not examined by the ACT. Thus, the evidence can also be said to be consistent with the view that the current regime sets up a contest over the distribution of resources which does not make positive contributions toward achievement of the NEO and NGO.

The issue (of distorted incentives to appeal) arises because the effects of a review decision on network charges may have only modest implications for economic efficiency, but much larger effects on the distribution of income between customers of NSPs and owners of NSPs, and it is the distributive effects that most directly affect the expected profitability of making appeals. There is therefore potential for excessive levels of economic resources to be devoted to conflicts over the distribution of resources, leading to a negative sum game. This is just one manifestation of a much wider range of types of ‘rent-seeking’ behaviours that can occur when the distributional effects of public decisions are considerably greater than their efficiency effects.

#### **4.7 The legal position**

As indicated above, there have been conflicting opinions on the extent to which it is possible to broaden the scope of ACT reviews under the current LMR regime. On the one hand, expert reports commissioned by the ENA and NSPs, and NSPs themselves, have argued that significant scope for broadening already exists under the current regime. On the other hand, a legal opinion commissioned by the Panel from the Acting Solicitor General, as well as the views of a former President of the ACT, Ray Finkelstein QC, indicate that there are substantial obstacles to such broadening.

The points that follow are focused on the narrower, legal aspects of the relevant matters, but the Panel also draws attention to the wider question of whether tribunal-based merits review is appropriate for revenue/price determinations that involve assessments that extend over relatively long time periods, involve the assessment of large quantities of information, require extensive consultation, affect a wide range of different interests, and have a relatively high policy context. The ARC, in its document ‘*What decisions are suitable for merits review?*’ in effect said that it is not, and the wisdom of this judgment has seemed to the Panel to become more impressive over time as we have learned more.

### *Opinion of the Acting Solicitor General*

The Panel sought legal advice from the Acting Solicitor General, Mr Tom Howe QC, on the question of whether the relevant provisions of the NEL and NGL permit the scope of a review to be broadened. The full Opinion of the Acting Solicitor General is attached as Annex 7 to this report, but the central conclusion of his analysis is succinctly captured in the following extract from that Opinion:

*“My short advice is that the relevant provisions of the NEL and NGL, properly constructed, do not permit the scope of a review to be broadened. However, matters not raised by an applicant or intervener (as distinct from grounds for review) may be considered in limited circumstances and for limited purposes.”*

In addition, in response to the question of whether or not there are other possible approaches which could allow for such a broadening of the review the Acting Solicitor General’s opinion was: “[t]he LMR regimes could be redrafted to establish a different merits review regime that, for example, does not specify or otherwise limit the grounds for review”. This potential option is discussed later, in our recommendations in section 5 below.

### *The views of Ray Finkelstein QC*

As indicated in the Review’s Stage One Report, it was the early submission of Ray Finkelstein QC that first alerted the Panel to the potential depth of the problems in relation to the broadening of the scope of review, and which stimulated the decision to seek a formal legal opinion. Mr Finkelstein has subsequently provided further views to the Panel, both in written form and in discussion, which we have found to be both extremely helpful in developing our thinking and broadly consistent with the views of Mr Howe and other senior legal figures.

In his first submission, Mr Finkelstein indicated that it was his view that, contrary to some submissions that had been made to the Panel on this issue, under the current statutory regime the ACT is simply not able to substitute what it considers to be a preferable decision when reasonable minds may differ. Moreover, the ability of the AER to raise new issues under the current regime was also confined. Specifically, in his first submission, Mr Finkelstein noted:

*“On a review the ACT will only reconsider the AER decision to the extent necessary to address the grounds of review. It is not permissible for the ACT to reconsider the whole AER decision.... From this structure of the Electricity law (and the equivalent Gas Law) it is apparent that the ACT’s consideration of a reviewable decision is limited to the grounds raised, either by the applicant or an intervener. Several submissions erroneously contend that the AER may raise new grounds, complaining that the AER has not done so on the past. The AER cannot raise new grounds.”*

The point appears to the Panel to be a fundamental one, since it suggests that, in relation to the overall revenue/price determinations, the LMR regime, as currently constituted, is not

able to fulfil the purpose of merits review, which is to review the merits of the decision made. Moreover, it raises two, related questions for consideration:

- To what extent is the existing ‘error-based’ approach of the LMR framework capable of being adapted to allow the review body to take account of broader considerations as and when necessary?
- Does the use of a tribunal for this task import a number of considerations into the decision making process that are unhelpful in the administrative task of testing out whether there are preferable decisions that could have been made in an area such as revenue/pricing determinations?

#### **4.8 Keeping merits review ‘limited’**

A number of weaknesses in the LMR regime identified in Stage One are associated with the combined effect of the specific nature of the grounds for appeal under the relevant provisions of the NEL/NGL (cited at 4.6 above), and the tendency for subsequent review to be ‘framed’ by those grounds of appeal – an effect that may be induced by the threat of judicial review of the ACT if it is seen to reach wider, or simply by the much more general ‘framing biases’ familiar from cognitive psychology research on decision making, or both. The practical effect of such a framing is that the four grounds of appeal have acted so as to limit the scope of merits review under the current framework.

Whilst it can be argued that this is what was intended – since the policy aim was to establish a ‘limited’ merits review regime – we do not think that it was intended that the baby be thrown out with the bath water. The current regime is certainly ‘limited’, but the ‘limits’ imply that it does not lead to review of the merits of the principal decision that matters – the overall revenue/price determination. As the Panel has stressed in its previous documents, on the basis of the reviews that have taken place, it is simply impossible to form a view as to whether the eventual decision, when different from that of the primary regulator, was or was not preferable on the appropriate criteria (deriving from the NEO and NGO).

Given the Panel’s overall conclusion from its Stage One work that, in order to do what it was intended to do, the review regime applied in the electricity and gas sectors must be capable of reviewing the merits of the principal decision, this leads immediately to the question of how a reconstructed merits review might also be limited so as to prevent the introduction of a set of arrangements that would imply full *de novo* review of decisions.

The Panel has considered the extent to which other, limiting factors can be used to contain the scale of review activity, whilst allowing broader scope in both grounds for appeal and in review assessments. As discussed in section 5 below, the Panel’s recommendation is that the various grounds for review under the relevant legislation be replaced with a single ground of appeal to the effect that there are reasons for believing that a preferable decision exists, and

hence that the primary regulator's decision does not promote efficiency for the long run interests of consumers (and, in that sense, the determination is 'wrong on the merits').

While this is clearly a broad ground for appeal; various 'limitations' can be introduced which could mitigate against any tendencies for the review to become a *de novo* review of decisions in each and every case. These include:

- Making the threshold for an appeal to be heard one that is based on convincing the review body not only that the decision is in some way defective, but that the evidence is such as to suggest that there is a significant prospect that a *materially* preferable overall revenue/price determination exists. As indicated below, whilst the Panel is of the view that the meaning of 'materiality' should be left largely to the discretion of the review body to determine in each case, in the light of the particular circumstances of the case, this is an area where greater clarity could be provided by *ex ante* guidance published by the review body.
- Requiring the primary decision maker to construct a 'record' of evidence collected during its evaluations which would then become the evidential/factual starting point for the review body's own work. Subsequent investigatory effort would then be incremental to that of the primary regulator, rather than *de novo*.
- As now, imposing time and resource constraints capable of limiting the level of review activity. Unlike now, however, reviewers would be free, within those constraints, to investigate any aspects of the decision that they consider would be the most informative in relation to the overall merits of the decision.

#### 4.9 Legitimacy and relative certainty

One of the concerns that the Panel has had throughout the review exercise relates to the legitimacy of the LMR regime. NSPs have been relatively content with the regime, and have tended to suggest relatively modest adaptations to deal with some of the problems that have been identified. Others, however, have been much more critical, and the critics include consumer representative groups, network user groups, and some parts of government wherein a number of experienced regulators reside. In one or two cases, the criticism has been to the point of anger. In addition, there now is at least one case where, in direct response to a decision by the ACT, state legislation has been introduced to negate the impact of an ACT decision on consumer prices.<sup>19</sup> That is not a sign that all is well.

---

<sup>19</sup> See the recent Press Release from the Victorian Minister for Energy and Resources: O'Brien M (2012) "Coalition acts to save consumers millions by scrapping electricity price hikes" Victorian Government Media Press Release 15 August 2012.

< <http://www.premier.vic.gov.au/media-centre/media-releases/4649-coalition-acts-to-save-consumers-millions-by-scrapping-electricity-price-hikes.html>>.

See also the 2011 Press Release from the Queensland Minister for Energy and Water Utilities which discusses the impact of an ACT decision: Robertson S (2011) "Minister Disappointed at QCA Electricity Pricing

The intensity of debate about energy price hikes and the causes of those hikes can be expected to wax and wane to some extent, as all such issues tend to do, but the underlying trend appears to be upward, driven by upward pressures on costs and the regressive effects of higher household energy prices on income distribution. The current structure of regulation, together with market reforms more generally, can therefore be expected to be subject to increasing media and political interest over time.

In these circumstances, in evaluating possible recommendations, the Panel has given significant weight to the possible implications of its recommendations for the legitimacy of the regime, and also to the relative certainty that recommendations made will be capable of delivering the type of outcomes that policy makers have intended. Delegated regulation is perhaps too arcane an area of policy to command popular enthusiasm, but it does depend upon a degree of acceptance by those affected. Without such acceptance, not only the LMR regime itself, but also the wider regulatory regime, and hence regulatory certainty, will be put at greater risk. Similarly, if, in an attempt to address weaknesses of current arrangements, the Panel were to put forward proposals that leave significant ambiguities and/or are highly uncertain in their effects, that would not likely be a helpful contribution to stability.

## 5. THE PANEL'S RECOMMENDATIONS

### 5.1 Framework, structure and procedures for future energy limited merits review

Following the approach set out in the Stage Two Interim Report, recommendations (i) to (ix) below seek to establish what, in the Panel's view, are desirable characteristics of the future merits review regime. They are proposals that are intended to address the identified problems with the current arrangements, irrespective of the institution that performs the review function.

#### *Statement of policy*

Our first recommendation is simply:

- (i) **That it be made clear by a policy statement that the aim of the merits review regime is to achieve preferable outcomes from the network regulation framework by ensuring that relevant decisions promote efficiency in investment, operation and use of networks, and are consistent with the revenue and pricing principles of the NEL and NGL, in ways that best serve the long term interests of consumers.**

The Panel starts with these points because we think it is important to clarify distinctions between ends and means, and to clarify the expected relationships between ends and means. We have found that some submitters have been of the view that the policy aim is to promote economic efficiency, and that promoting efficiency will always be in the long term interests of consumers. If that view were accepted, an economic error would have been written into the Energy Laws, and the Panel believes it should be made clear that this is not the case. The words "*in ways that best serve*" are intended to reflect the point that there may be many ways in which efficiency can be improved and that preferences among them should be determined by reference to the long term interests of consumers. The underlying task of merits review for these types of decisions is to promote the achievement of preferable decisions. It is therefore necessary to be clear about what criteria are to be used when judging whether one decision is preferable to another.

Similarly, in the course of consultations, it has become apparent that there is a tenaciously held belief that correcting some errors in a decision will automatically lead to a preferable decision. That too is an economic mistake, which the Panel has tried to explain to those arguing the point, with, we suspect, only limited success. A clear statement to the effect that the policy aim is preferable decisions, not error correction (and that the two are not equivalent), would therefore be helpful.



### *Clarificatory amendment to the NEO and NGO*

In addition to such a policy statement, the Panel recommends that the matter (that, ultimately, ambiguities in interpretation of the Energy Laws should be resolved by reference to the long term interests of consumers) be addressed by a simple amendment of the NEO and NGO as follows:

- (ii) **The words “in ways that best serve” be inserted for the word “for”, before “the long term interests of consumers”.**

By way of further explanation of these recommendations, the Panel notes that even an efficiency assessment typically requires a balancing of allocative, cost and dynamic efficiency considerations, which may be differentially affected by alternative potential decisions. There are trade-offs among these various dimensions that need to be resolved by reference to some balancing or weighting of the different elements, and this balancing/weighting usually depends upon a value system beyond the notion of economic efficiency itself. It is the Panel’s view that this is precisely what the reference to ‘for the long-term interests of consumers’ in the legislation provides, and the recommendations therefore serve to reinforce the intended meaning.

### *The purpose, nature and scope of merits review*

Moving on to what it is that should be subject to merits review, as discussed in section 4.1 above, it is the Panel’s view is that in terms of price and revenue control decisions it is the overall revenue determination that is the key decision, and that should therefore be the focus of any ‘merits review’ (and not the various ‘constituent decisions’, which, as we have pointed out, are not actually decisions at all). Again the ultimate criterion for judging alternative policies should be the long-term interests of consumers, or what in economics would usually be called long term consumer welfare. In this context, we note that the NEO and the NGO are formulated in terms of promoting efficiency for the long term interests of consumers and, for reasons discussed above and subject to the clarifying amendment suggested above, believe that this is a good way of putting things. The decisions of the primary regulators concern the activities of the NSPs, and it is therefore reasonable to cast the objective in terms of promoting those things that are within the control of the NSPs (investment in, operation of, and use of networks).

The Panel recommends that:

- (iii) **Appeals should only be allowed/upheld if, on the basis of relevant evidence and substantiated reasoning, the review body is convinced that there exists a materially preferable decision. In cases involving adjustments, or potential adjustments, to an overall revenue/price determination, this necessarily implies that the review body is able to, and should, assess the merits of that**

**overall revenue/price decision, examining any aspect of the decision that it considers would throw light on its merits.**

The Panel is of the view that for an appeal to be successful it is necessary that the review panel reach the conclusion that there is a materially preferable decision to that which has been made by the primary decision maker. The reference to '*materially preferable*' provides a means of limiting appeals activity, so as to reflect the costs that the appeals process imposes, both in terms of resources and delay. The wording is not precise, but **we recommend that it be left to the review body to determine the materiality threshold in practice.** Initial uncertainty could be reduced by the publication of guidance by the review body.

One way of working would be to link the materiality threshold to the nature of the appeal that is brought before the review body. In some cases, what might be at stake could be a relatively limited set of issues that can be dealt with quickly, and at little cost, in which case an appropriate materiality threshold might be set quite low. On the other hand, if what is required is an extensive investigation, then the threshold can be set higher, so as to ensure that there are incentives only to make such appeals if the potential benefits are high. That is, materiality can be used to establish a degree of proportionality between likely costs and benefits of review. Again, initial concerns that the review body may not be consistent in its application of the materiality threshold could be addressed by a requirement for it to publish guidance on how it would approach the issue of materiality in practice.

The Panel recognises that this recommendation will have the effect of moving the merits review framework away from what is effectively an 'errors-based' approach towards an approach focussed on directly assessing the 'merits' of a relevant decision, and in particular to a focus on whether a materially preferable decision exists. There are a number of reasons why the Panel considers such a change in the merits framework is appropriate.

First, and perhaps most importantly, in its Stage One Report the Panel identified a number of significant flaws in the current LMR framework. Specifically, the Panel concluded that the approach that had developed was one that was unduly focused on the 'correction' of errors, and as a consequence, in many decisions the question of whether or not the ACT's varied decision was, in fact, preferable to that of the primary regulator was not even asked, let alone addressed. This may have developed from the 'correct or preferable' standard that is associated with merits review more generally. The notion of error is closely connected with the correct/incorrect dichotomy, but, as has been noted earlier, the correct/incorrect dichotomy is not the appropriate arm of the standard for decisions that may have multiple, possible outcomes. In practice, revenue/price determinations cannot meaningfully be said to be correct or incorrect, and piecemeal correction of individual errors in the assessments underpinning the decision do not necessarily lead to a preferable decision.

Secondly, as it has developed in practice, the LMR regime has, contrary to intentions, been associated with a high-level of appeal activity. While it was clearly one of the policy

intentions of the MCE to avoid the costs likely to be associated with full *de novo* review of each and every decision, the record shows that what has developed is a situation where almost all revenue and price control decisions are appealed, but only on selected grounds. There appears to have been more than one contributory factor at work at here, but the limitations on the ACT's ability to examine material not linked closely to the grounds of appeal do contribute a 'one-sided' aspect to the process, which by and of itself is capable of contributing to excessive levels of activity. An appellant is able to exert a certain degree of influence or control of the ACT's agenda, which imparts a bias to the review process.

Thirdly, as the Panel also indicated in its Stage One Report, one of the principal deficiencies of the LMR regime as it has developed is the ability of consumers and other interested groups to participate effectively in the review process. While the Panel recognises that this may be the result of a number of factors, it considers that the 'error correction' focus of the application of the current LMR regime has been an important contributing factor. This follows from the first two points noted above which highlight the fact that, having identified an error, the ACT has then not typically gone on to consider whether or not the correction of the identified error will result in a preferable decision being made. It is in this latter stage of the process where it might be expected that the views of consumers and other interested parties would be most relevant.

Finally, the Panel notes that Australia is not alone in finding that, where approaches to limiting appeals to the correction of errors in a regulated sector have been followed, there has been a tendency toward high levels of appeal activity. In the UK telecommunications sector, for example, there is an active debate about whether the appeals framework should be reformed to address concerns about the high frequency of appeals and the associated costs.<sup>20</sup> Like the LMR regime, and unlike in the other utility sectors in the UK, the UK appeals regime for price control decisions in the telecommunications sector is based on a so-called 'enhanced adjudication' model and is focussed on the correction of various errors that have been identified by the parties in their grounds of appeal. Critically, and like the LMR regime, the review arrangements do not permit the review body (in this case the Competition Commission, upon receipt of a request from the Competition Appeal Tribunal) to investigate other aspects of the decision at its own initiative, when conducting its review of the regulators decision.<sup>21</sup>

#### *A single ground for appeal*

In support of the review body's capacity to examine any aspect of a regulatory decision that it considers would be informative in assessing the merits of the decision, and hence to help

---

<sup>20</sup> A UK National Audit Office report published in November 2010 noted that Ofcom had been appealed 35 times under section 192 of the Communications Act since 2003, and that the cost of appeals to Ofcom was over £1 million per year since 2007-08. National Audit Office (2010) 'Ofcom: the effectiveness of converged regulation', November 2010.

<sup>21</sup> In this respect the Competition Appeals Tribunal has ruled that an appeal is reviewed through the prism of the specific errors that are alleged by the appellant.

ensure that it is not prevented from examining information potentially relevant to its own decision<sup>22</sup>, the Panel recommends that:

- (iv) **There should only be a single ground for appeal, which is that there are reasons for believing a relevant decision may be defective in that a materially preferable decision may exist, and hence that the primary regulator's decision does not promote efficiency for (alternatively, in ways that best serve) the long term interests of consumers (and, in that sense, is 'wrong on the merits').**

This proposal links the ground for appeal directly to the central question of merits review itself: is there a materially preferable decision (in terms of the long run interests of consumers) to that taken by the primary regulator? According to this formulation, a defective decision is one where there exists a materially preferable decision as judged by the NEO and NGO.

As in relation to the interpretation of materiality, the Panel suggests that it should be left to the discretion of the review body to give more precise content to the strength of the case required for an appeal to be heard, allowing it to do so in a way that is proportionate in the relevant factual context. For example, if there is suspicion that the primary decision maker has made a mistake with potentially large consequences for consumer welfare, the review body might be persuaded to open a review even if it was convinced there was only a moderate probability that such a mistake actually existed. On the other hand, if the apparent potential benefit of opening a review appears smaller to the review body, it might judge that more convincing evidence would be required from an appellant at the outset in order to justify the opening of a case. Again, therefore, the proposal would see the review body as the cost-benefit gatekeeper, keeping the scale of review activity in proportion to the likely benefits.

On this point, the Panel makes the observation that such an approach is not dissimilar to the 'reason to believe' threshold that is applied by the ACCC in certain areas of its enforcement work. For example, under Part XIB of the *Competition and Consumer Act 2010* (Cth), the ACCC can issue a competition notice to telecommunications carriers if it has a 'reason to believe' that the carrier has engaged in anti-competitive conduct.<sup>23</sup> This standard has been interpreted as requiring the ACCC to form a view, in good faith and on reasonable grounds that a telecommunications carrier has engaged in anti-competitive conduct, and is distinguished from a standard which requires that sufficient evidence be adduced to convince a court that a contravention has occurred.

---

<sup>22</sup> It is somewhat paradoxical that, if a regulator neglected to consider information that was relevant to its decision, this would be a ground for judicial review. In effectively preventing the ACT from considering information and evidence that is relevant to the original decision, the LMR regime prevents the ACT from 'standing in the shoes' of the regulator. This is one of the reasons why the Panel has concluded that LMR, as currently established, is not actually merits review in the usual sense of the term.

<sup>23</sup> *Competition and Consumer Act 2010* (Cth) s151AL.

The Panel also notes that the replacement of the current grounds of appeal with the proposed single ground of appeal outlined above does not limit the potential for interested parties to raise points that they would have raised under the current LMR framework. That is, the more general nature of the proposed single ground for appeal would still allow interested parties to challenge a decision on the basis that it contained a material error of fact; constituted an incorrect exercise of discretion; or was unreasonable, and that a materially preferable decision exists. The broadening of the ground of appeal in the way formulated above does, however, leave open the possibility that interested parties could succeed on other bases in addition to the grounds of appeal that exist under the current LMR framework. This leaves flexibility, but, in a revenue/price determination case, an appellant would still need to convince the review body that the problems identified had sufficiently significant implications for the overall determination that they put the merits of the original decision in question. There would be no rigid quantification of the threshold effect (on the overall decision) required for a case to be opened, providing scope for the review body to adjust this in a way that is proportionate to what it perceives to be the significance of the issues and the likely costs of the particular investigation.

The Panel also notes that the recommendation as to the grounds for merits review does not limit the ability of interested parties to apply for judicial review of relevant decisions. This point may be of particular relevance for those parties who have argued that, under the Australian energy regulation arrangements, the discretion of the primary regulator is highly limited, that its task is simply to comply with the rules developed by the AEMC, and that, if it does so, the best decisions will somehow emerge at the end of the process. Although the Panel disagrees with such an interpretation of the arrangements, it makes the observation that, if the arrangements do imply something significantly closer to this situation of extremely limited regulatory discretion than the Panel believes to be the case, any failure of the primary regulator to comply with the relevant rules is clearly a matter that can be pursued through the process of judicial review.

*Substitution of an investigative process for an adversarial process*

Since the Panel is of the view that the current LMR regime has created an adversarial contest in which there are incentives toward excessive appeals activity, it recommends that:

- (v) **The review body should adopt an investigative approach to reviews of the relevant decisions, and should be subject to specific duties, such as those listed below.**

The main activity of the review body when a review is launched should, in the Panel's view, be investigation. In making this recommendation the Panel seeks to move the review framework away from one that is based on an adversarial approach towards one where the

principal task of the review is the investigation of relevant matters.<sup>24</sup> This shift in approach is appropriate in the Panel's view because of the specific types of issues that arise in revenue/price control determinations.

Speaking generally, the Panel considers there to be great merit in adversarial-type review processes in many contexts, particularly when the issues at stake are binary in nature (guilty/not guilty; infringement/non-infringement; allow merger/prohibit merger), or where there are a limited number of options. 'Advocates' for those (limited in number) positions can then compete, and reviewers can adjudicate. However, it is the Panel's view that the nature of the issues that are at stake in a price/revenue control decision are typically not like that; and nor are the related issues of establishing incentive structures for regulated companies. The decision maker is, in the relevant circumstances, 'standing in for the market', since market outcomes are considered unacceptable in the relevant, monopolistic conditions. Market processes 'discover' values and establish incentive structures, from an infinite range of possibilities, and the regulator does the same, driven by delegated objectives. It is appropriate, therefore, to review decisions on a basis that addresses this reality, and that does not tend to rely on thinking more suited to the assessment of binary decisions.

**To give effect to this investigative approach the Panel recommends that the review body be given specific duties, among which should include the following:**

- **To decide whether a ground for review has been established (see points above for the relevant test), and, if so, to open a review.**
- **To adopt the 'record' of the primary decision maker as the starting point for its own review (and hence not undertake a *de novo* review, in the sense of starting again).**
- **To supplement the record with evidence from its own investigations where considered appropriate.**
- **To invite all interested parties to give views.**
- **To assess whether a materially preferable decision is available.**
- **If such a decision is available, to substitute a preferable decision, or to remit matters to the primary regulator for further consideration.**
- **To make decisions in relation to the allocation of costs of appeals.**

---

<sup>24</sup> In the context of tribunals this distinction is sometimes cast as one between adversarial approaches and inquisitorial approaches. However, in a context in which one of the goals is to encourage the contribution of consumer voices, the Panel finds the notion of 'inquisition' to be unhelpful.

- **To publish guidelines on the review body’s procedures, particularly so as to assist interested parties in the first years of the new arrangements. The guidelines might cover matters such as principles for cost allocation, the circumstances in which an interested party would typically be given its own hearing, circumstances in which there would tend to be substitution of decisions rather than remittal, when public hearings might be held, etc. Some of the content of the guidelines should be directed toward limiting the scale of the investigations – e.g. explaining that not every participant could expect a hearing, that detailed repetition (rather than summaries) of evidence already on the record could be treated as vexatious, and so on.**

*Equitable and open access to the appeals process*

In relation to the question of who should be able to appeal, the Panel recommends that:

- (vi) **Applications for review should be open to regulated network businesses, energy ministers, consumer/user representatives, and other parties with a sufficiently material interest in the decision.**

In making this recommendation the Panel recognises that there is an obvious trade-off between granting wide access to the review process to those affected by decisions, and the need to ensure that such rights of access will not lead to very high levels of review activity such as to cause additional costs and delay in the regulatory process.

In the Panel’s view, the need for wide and neutral rights of appeal and intervention is an inevitable consequence of the fact that the relevant decisions effect a range of different stakeholders (such as network users, final consumers, shareholders and taxpayers), and that all interested parties should be able to challenge decisions in circumstances where they consider that a materially preferable decision exists. It is also consistent with the previous recommendation that the approach of the review body be investigative rather than adversarial in nature. As has been demonstrated by the operation of the LMR regime to date, exclusion is not good for legitimacy.

This does not mean, however, that all applications for review by interested parties would or should be automatically approved. As indicated above, the Panel recommends that the substantive test for deciding whether or not to open a review of a decision should be that there are reasons for believing a relevant decision is defective in that a materially preferable decision exists. It is the Panel’s view that this threshold be applied in the same way irrespective of the party that makes the appeal.

*The range of decisions to be subject to merits review*

A less clear cut issue is whether or not there should be a differentiated merits review procedure for revenue/price determinations, but not for other reviewable regulatory decisions concerning energy networks (as, for example, is the case in the UK telecommunications sector). The Panel's recommendation on this matter is that:

- (vii) The same body should handle the review of all decisions where the AER is the primary decision maker. Consideration should be given to whether certain decisions of the NCC and State Ministers in the gas and electricity areas should be reviewed via the same or via a separate process.**

The NEL and NGL currently specify the types of decisions that are subject to merits review by the ACT. In electricity, according to s71A of the NEL, 'reviewable regulatory decisions' include: (a) a network revenue or pricing determination that sets a regulatory period; or (b) any other determination (including a distribution determination or transmission determination) or decision of the AER under the Rules that is prescribed by the Regulations to be a reviewable regulatory decision.

In gas, s244 of the NGL, sets out eight different types of reviewable regulatory decisions, including: decisions of Ministers in relation to coverage; decisions by the NCC in relation to light regulation, including decisions to revoke (or not revoke) a light regulation determination; and the following decisions of the AER - applicable access arrangement decisions (other than a full access arrangement decision that does not approve a full access arrangement); AER ring fencing determinations; decisions of the AER under s146 to give an exemption; or an associate contract decision. In addition, the ACT has jurisdiction under the NGL to review decisions of an original decision maker that is prescribed by the Regulations to be a reviewable regulatory decision.

To date, the majority of the appeals activity of the ACT has concerned revenue and price control determinations in electricity and applicable access arrangements in gas. However, the ACT has, on occasion, been asked to consider issues relating to a Ministerial decision to cover particular gas pipelines.

For the reasons explained below, it is the Panel's view that the review of decisions relating to revenue and price control determinations (defined to include applicable access agreements in gas) in both gas and electricity should be handled by the same body. It is also the Panel's view that other types of decisions where the AER is the primary decision maker should be considered by the same body as is responsible for the review of revenue/price determinations. This is largely for practical reasons of consistency and administrative expediency (to avoid different types of AER decisions being subject to different review processes), but also because such decisions tend, by their nature, to involve detailed review of aspects of the exercise of regulatory discretion which have some similarities with aspects of revenue/price determination work.



The question that arises is whether the same or similar reasoning applies to decisions taken by the Minister in relation to gas pipeline coverage, and decisions of the NCC in relation to the form of regulation to apply in gas, and whether there is merit in having them also reviewed by the same body.

A number of considerations are relevant to this question, some of which extend beyond the scope of the current Review. On the one hand, there may be advantages associated with retaining the current review arrangements for these types of decisions in so far as it is consistent with the review arrangements that exist for Ministerial declaration decisions more generally under the Part IIIA access framework of the *Competition and Consumer Act 2010* (Cth). On the other hand, there is a wider question about whether it may be worth considering transferring the primary decision making responsibility for these types of decisions from Ministers (in relation to coverage decisions) and the NCC (in relation to form of regulation decisions) to the AER. Such a transfer of responsibilities could potentially yield benefits in terms of reducing the number of administrative bodies involved in regulatory decision making, increase the concentration of skills in the AER and be consistent with the approach that is currently taken in electricity, where the Minister and the NCC have no involvement on coverage/declaration and form of regulation decisions.<sup>25</sup>

However, these potential benefits need to be weighed alongside the fact that any such transfer of responsibilities may lead to a situation where the AER may take a different approach to questions of coverage and form of regulation issues to that currently adopted by the Minister and the NCC. This is relevant to the extent to which there may be a potential tendency for the AER to view issues relating to coverage and form of regulation in gas through the lens of natural monopoly. In Australia, as in many jurisdictions, it is the case that potential exists for competition among different long distance gas pipeline operators (i.e. they are not natural monopolies). In this context it can also be noted that, compared with distribution and electricity transmission revenue/price determinations, much less evidence of things going materially wrong with current review arrangements was presented to the Panel in relation to gas pipeline decisions.<sup>26</sup>

While these issues extend into wider matters concerning the allocation of responsibilities among different primary decision makers, on balance it is the Panel's view that there would be merit in assigning all review responsibilities to the same body, and therefore in transferring the relevant decision making roles of the Minister and the NCC to the AER.

#### *The role of the AER in the review process*

At an early stage of its Review, when it was still puzzled by the hesitation of the AER in using the options afforded by the Energy Laws – specifically s71O(1) of the NEL and s258

---

<sup>25</sup> The Panel recognises, however, that the factual context is somewhat different in electricity transmission.

<sup>26</sup> However, the Panel is obviously aware of recent Court decisions relating to declaration decisions in other sectors of the economy, and how such decisions are reviewed by the ACT.

of the NGL – to seek a broadening of the scope of ACT reviews, the Panel was struck by differences of view as to the role played by the regulator at the appeal stage. Some parties argued that, when one of its decisions was appealed, the AER should act as a contradictor. The AER expressed the view that it could not do this because it was bound by the model litigant code. Other parties claimed that, notwithstanding that code, it was their experience that the AER did defend its position vigorously. Yet other parties told us that it did not. There was, to say the least, some confusion on these matters.

Reform of the merits review regime would provide an opportunity to resolve this further set of ambiguities in the existing arrangements. The Panel recommends that:

**(viii) The AER’s functions and duties in relation to the conduct of merits reviews should be set out more clearly in the NEL and NGL.**

In addition to the over-arching duties to promote the NEO and NGO and to take account of the revenue and pricing principles, these could include requirements:

- **To provide the review body with the record of the case, in a manageable form and with explanatory summaries of major sections of materials.**
- **To assist the review body’s investigation in interpreting the record by providing technical advice and in explaining the AER’s views of the material that it contains.**
- **To give its views on the reasoning and evidence put forward by appellants when asked to do so.**
- **To bring to the attention of the review body any matter that it considers to be of significance in relation to the task of evaluating whether there are materially preferable decisions to its own.** (This function is, in effect, a generalisation of its ability under the current arrangements to introduce wider considerations where it considers that matters are being considered in too narrow a way.)

As these proposals indicate, the AER’s role in the review process should not be that of a contradictor. Such a role would be inconsistent with an investigative, non-adversarial review process. Nor should the conduct of the AER be that of a ‘model litigator’, since there is, under the Panel’s proposals, no litigation, and no quasi-litigation of the type found in court-like administrative tribunals.

*Other constraints to limit costs and prevent undue delay*

**(ix) Time limits on hearing of appeals should be retained but relaxed.**

The Panel recommends that certain statutory time limits be placed on the hearing of appeals in order to provide limits on the scope of review activity, and also to provide greater certainty to all stakeholders as to when decisions subject to review will become effective. While the Panel is of the view that the time limit for appeals should be proportionate to the underlying nature of the substantive issues subject to review – with less complex, and more limited issues being considered in quicker times – it favours an outer limit for any appeals process of six months for revenue/price determinations, with the possibility of extension in certain circumstances.

These proposed time limits are longer than those under the current review arrangements, but the Panel is of the view that an extension in time limits is proportionate. For reasons already given, merits review of revenue/price determinations requires that the merits of the central decision be assessed, and anything less risks flawed processes that perhaps counter-intuitively, tend to lead to excessive numbers of appeals and excessive levels of appeal activity. Given the information-intensity of a merits review process, reviewers need time to explore and investigate different aspects of the relevant decisions.

The relaxation of time limits does not imply that we think that the overall level of appeals activity will increase. To the contrary, by making increased time potentially available for individual cases, appellants can expect that a number of aspects of a decision will be examined, not just those aspects on which they believe they have a better case to argue. This helps remove the ‘one-way’ incentives that develop when an appellant can influence where a review will focus attention, and hence serves to reduce excessive appeals activity arising from this bias. Thus, while the Panel expects individual appeals to take longer, it expects the number of appeals to fall, with good prospects of reducing the overall level of review activity.

## **5.2 Future institutional arrangements for energy merits review**

The recommendations described above represent what are, in the Panel’s view, desirable characteristics of the energy merits review framework. A different, but closely related, issue concerns the institutional arrangements most suited to developing these desirable characteristics. The recommendations in this section relate to that issue.

*A fully administrative review body, the AEAA*

- (x) The appeals functions of the ACT should be transferred to a new review body that is fully administrative in character (i.e. is not a designated tribunal). For convenience, in what follows we will refer to this as the Australian Energy Appeals Authority (AEAA).**

The Panel has given much thought to the question of whether either the ACT, or some other form of tribunal, could be modified and developed to operate effectively in the manner proposed. Among other things, this would require changes of law to direct the ACT to assess overall revenue/price determinations, and the provision of sufficient resources to carry out the necessary investigative tasks.

Whilst not ruling out the possibility that such an outcome is feasible, the Panel has reached the view that there would be a variety of significant obstacles to overcome, and that there is substantial risk that such an attempt would fail. Relative to the recommendations made below, there are also some distinct disadvantages of requiring the ACT to undertake the required tasks. The factors that have weighed most heavily with the Panel in reaching this conclusion are as follows:

- The ARC reasoning in *‘What decisions should be subject to merits review?’* Specifically, in that document the ARC noted that in some circumstances it may not be appropriate to apply merits review of the form developed by Australian tribunals, and, among the examples of types of decisions that may not be suited to merits review, the ARC cited those that tend to involve extensive inquiry and consultation processes, and decisions affecting multiple interest groups, with high policy content. These are plainly characteristics of revenue/price determinations.

The Panel has not, however, concluded that merits review should be abandoned for the relevant regulatory decisions. The ARC view relates specifically to a context in which merits review is conducted by administrative tribunals, and wholesale abandonment of merits review would not be in line with international best practice, which recognises the importance of independent review and auditing of the activities of government agencies. Rather, the Panel’s conclusion is that a different form of merits review is required, limited not by restricting the scope of reviewers to investigate, but rather by the resources that are allowed to the reviewers, and by the test criteria and standards of assessment that they are expected to apply.

- The apparent tension in a tribunal-based system between pressures for court-like, quasi-judicial processes, and pressures for tribunals to be more investigative/inquisitorial, speedy, informal, and low cost. One of the things that the Panel has discovered as it has wrestled with the issues in the context of the LMR regime, is that there has been a longstanding, substantive discourse on these tensions in relation to the operations of tribunals in general, even in contexts where it recognised that the tribunal system is much better adapted to the tasks at hand – e.g. where simple, binary decisions are involved – than it is for price control decisions (see the preceding bullet point). Since this wider debate is far from resolved, the Panel has concluded that it is unlikely that it could recommend reforms of a type that have been advocated and tried, with only limited success, in other contexts – e.g. that the ACT should shift away from court-like, quasi-judicial modes of operation – with any realistic expectation that, if acted on in the energy network context, such

proposals would meet with success. A number of the more general issues are discussed in Annex 2.

- Linked to the above points, the tribunal approach appears to come with a number of constraints, emanating from its connections with the judiciary, that may restrict its ability to undertake the kinds of tasks that the Panel believes are necessary to achieve an effective limited merits review system, some of which we have likened to audit functions. We were informed, for example, about the risks of successful judicial review if the ACT took what the higher courts might view as excessively expansive view of its own powers to investigate, as well as of practical issues such as the constraints imposed by operation of detailed matters such as the judicial docket system. Thus, although the ACT is deemed to be part of the administrative process, it was made clear to us in a number of conversations that the notion that it could ‘stand in the shoes’ of the primary regulator was, in fact, misleading, and that its powers were, in reality, much more limited than that. Whilst the Panel recognises that the court-like, quasi-judicial approach can sometimes bring major advantages to administrative decision making, it also notes that the entanglement of the judiciary with the settling of contentious political issues can have also have unwanted effects in the other direction: it can politicise parts of the judicial system in ways that challenge separation of powers and that put the judiciary itself under increased public scrutiny. It is perhaps for this reason that we have found past and current judges hesitant in their contemplation of the prospects of taking on the sorts of tasks that the Panel has identified as being important for effective merits review. We note that this a not peculiarly Australian form of diffidence: most judges in comparator jurisdictions are very wary about getting involved in the contentious business of price control, as can be seen from the case record of competition law cases in those jurisdictions in which excessive pricing is a potential infringement.
- The views and opinions expressed by some respondents during our consultation process, particularly those who have a first-hand understanding of the ACT and its operations, were not notable for their enthusiasm about the prospects for reviews with wider scope. For example, Ray Finkelstein QC, a past President of the ACT, made the following observations on this issue:

*The Expert Panel at various points has raised issues about the appropriateness of the ACT, given its resources and personnel, to undertake comprehensive reviews of pricing decisions. In my view there are serious doubts about whether the ACT is the appropriate body to hear such pricing reviews. Hearings are presided over by a judge. A judge is neither by training nor background suited to making the either economic or policy decisions that would be involved. Judges resolve disputes by explaining legal principles and applying those principles to the facts. It may be preferable to use an internal review system or specialist external body, with an ability to refer questions of law to the Federal Court for determination.*

- There are significant problems in recruiting and retaining suitably qualified staff, which more comprehensive reviews will require. Any stand-alone support organisation for a tribunal will be small in scale and might have a highly intermittent work load. These issues are addressed in the Panel's recommendations below by resource sharing with another administrative organisation, but such a solution would appear to be much more difficult to implement in the case of a tribunal, which, in the judicial tradition, we would expect to be averse to such institutional affiliations.

For all of these reasons, the Panel recommends that a new review body, which is not related to the ACT, and is fully administrative in character, undertake merits review of relevant decisions in the energy sector.

*The composition and resources of the AEAA*

- (xi) **The Panel recommends that the AEAA comprise a standing panel of potential reviewers, of whom five would be chosen to consider individual cases. The AEAA should be supported by a small support team with relevant expertise, members of which may participate on a temporary or intermittent basis.**

In terms of institutional structure the Panel's recommendation is that the AEAA be comprised of a relatively large number of potential reviewers to be called upon as and when cases arise. Since the work flow would be uncertain, it might be appropriate to remunerate members on the basis of a small retainer plus per diem payments based on time spent on review matters.

We favour this larger (than current) number of potential reviewers because of the range of issues that can arise in a price control review, and because of the substantial element of forward-looking assessment required. A larger panel allows a variety of skills and wider range of know-how to be brought to the table, and when trying to assess future developments there is particular value in having input from a range of perspectives. In particular, diversity of perspective/view can reduce the risk that something fundamental is missed.

The recommendation as to the support team follows directly from the fact that the number and frequency of appeals is necessarily uncertain, and it would be administratively inefficient to have a full team established on a permanent basis. Moreover, we think it would be very difficult to attract people with the necessary qualities to a job that might require only intermittent periods of work on problems of a broadly similar type.

*An independent body, but hosted by an established administrative organisation*

- (xii) **The AEAA should be an independent body but, principally for reasons of cost and staff recruitment, should be attached to an existing administrative organisation, rather than be established as a stand-alone body.**

As already indicated, the Panel carefully considered the possible advantages and disadvantages of different forms of institutional arrangements including whether the development of a stand-alone review body might best achieve the desired objectives of the merits review regime in the energy sector. Although the Panel considered that a stand-alone review function would be feasible as an option, it nevertheless came to the conclusion that there are likely to be significant advantages in attaching the review body to an existing administrative agency.

The principal advantages of such an arrangement are greater continuity in staff support (core support staff, though not necessarily all such staff involved in a particular review, could be drawn from the host agency), and, perhaps even more importantly, the work would be more attractive to high quality public servants if part of a wider portfolio of work requiring similar types of skills. In addition, as indicated in the previous recommendation, the number and frequency of appeals is uncertain and likely to be intermittent, and attaching the review body to an existing agency will bring the benefit of allowing for staff to be engaged in other aspects of work in the energy sector in periods when there are no appeals before the AEAA.

#### *The AEMC as the preferred host agency*

#### **(xiii) The Panel recommends that the host agency for the AEAA be the AEMC.**

The AEMC has advantages relative to other candidate agencies in terms of the technical support it could offer. It is an organisation dedicated to energy matters, and its staff therefore has relevant knowledge, skills and know how-that they could bring to revenue/price determination assessments.

The Panel also sees some distinct policy advantages in an AEMC connection. As discussed earlier, the functions of the NER and NGR in their application to primary regulators is supervisory in nature: the rules serve to constrain the discretion of the regulators. Merits review also serves supervisory purposes. The aim in the individual case will be to determine whether a materially preferable decision exists but, as was made clear at the outset by the MCE, and as was argued in some submissions, a wider purpose is to improve the quality of primary decision making. Indeed, in a well functioning regime, the latter is likely to be the predominant effect, since with high quality primary decision making it can be expected that the scope for finding materially preferable decisions will be significantly reduced.

We have noted that rule changes currently under consideration by the AEMC tend to have the effect of affording the AER greater discretion in its decision making. Again, in a well functioning regime, it might be expected that any reduction in supervision *ex ante* (i.e. via rules) might well be accompanied by adjustments to supervisory arrangements that operate on an *ex post* basis, as appeals/review processes do. At a minimum, if the primary regulator is given more discretion, it might be expected that there would be some simultaneous consideration of whether, on standard checks and balances arguments, the extra

power/discretion granted merited some counter-balancing adjustment in supervisory arrangements. The panel therefore sees merit in having these two aspects of supervision – via rules and via the oversight of standards of (primary decision making) performance – which need to be coordinated in some way or other, under the same organisational roof.

This does not imply that there should be a high level of interaction between the AEAA and the AEMC more generally, but some degree of interaction – such as regular, periodic meetings between AEMC Commissioners and AEAA members to discuss developments in *ex ante* and *ex post* supervision – is, we think, positively desirable.

The Panel notes the arguments of those who believe that such an arrangement would undermine the policy of separation of rule-making and enforcement that underpins the existing institutional arrangements, but is of the view that the points are much exaggerated. As explained earlier, the particular rules at issue are not ones that primary regulators enforce, they are rules that they comply with. Rules that are enforced by the regulators are not affected by our proposals; and violation of the NER or NGR, which have the force of law, by a primary regulator would still lead to the possibility of judicial review.

It remains the case that, alongside its rule-making powers, the AEMC would have secondary decision making powers ‘under its roof’, which overlap with the decisions of the primary regulators. However, the overlap is relatively small in scope. What is proposed is not *de novo* review, but rather something closer to an auditing approach, based first on the application of limited assessment resources to an existing body of material, but not constrained in relation to where investigative attention might be directed and with the ability to gather and test new evidence, on an incremental basis, where appropriate.

It would be possible to arrange for complete, ‘internal separation’ of the work of the AEAA from the other work of the AEMC, but this would imply the loss of the advantages outlined above. The Panel’s view is that significant separation is warranted, in order to provide diversity in perspectives on the relevant issues (i.e. another independent pairs of eyes), but that it should not be complete.<sup>27</sup>

Finally, the Panel makes the observation that specific features of the AEMC’s governance arrangements may bring additional benefits to it hosting such a review function insofar as the AEMC was itself established by the Council of Australian Governments through the MCE. The participation of all of the Australian Governments – both Federal and State – in the creation and governance of the AEMC may facilitate the quicker development of authority and acceptance for the decisions of the AEAA, as an associated body of the AEMC, and also help underpin its independence from short-term political influences, since, at any one time, the various governments may well have different views on relevant matters.

---

<sup>27</sup> In this respect the Panel makes the observation that the court-like, quasi-judicial characteristics of the existing tribunal structure are arguably in greater conflict with principles of separation of powers/functions than are the Panel’s proposals.



As part of its deliberations on this recommendation, the Panel also considered the ACCC as a potential host organisation for the AEAA. The ACCC is the Australian competition law regulator with extensive experience in the enforcement, ultimately through court action, of the anti-competitive conduct, fair trading and consumer protection provisions of the *Competition and Consumer Act 2010* (Cth). In addition the ACCC administers Part IIIA of that Act dealing with conditions of access to the services of defined essential facilities and it has natural monopoly regulation roles in the telecommunication, transport and water sectors. The ACCC therefore also has a capacity to provide expert technical support to the AEAA, and it is an organisation with a strong international reputation.

Given that the AER is currently part of the ACCC, the Panel considered whether there were obstacles in the form of perceptions of lack of independence (from the primary decision maker) at the review stage that would effectively rule out the option, and concluded that, whilst this was a drawback, it was not necessarily a fatal one. Internal separation, to ensure that AEAA panellists and support staff had had no involvement in the primary decision, should be sufficient. There are also international precedents for primary decision making and review to be located within a single organisation, with provisions for internal separation to ensure that the review function is performed with fresh and unprejudiced eyes.

The more difficult issue is that the ACCC's central activities are, unlike the AEMC's, those of a primary decision maker, which potentially gives rise to a 'lack of fit' with the supervisory/review role required. The ACCC itself was not attracted by the idea of attempting to combine the two functions, for reasons that the Panel fully understands and accepts. Whilst an ACCC linkage would remain feasible if there were full 'internal separation' of the AEAA from the other activities of the ACCC, this would defeat the purpose of establishing such an organisational linkage in the first place: the review body might just as well be stand-alone.

The ACCC's concerns about linking primary decision making with review accord with the Panel's own views on what is and what is not important in relation to the separation of functions. Relatively rigid separation of primary decision making and supervisory review of such decision making is very important because, to maximise the chances of arriving at the most preferable decisions, independent reviewers, who can bring fresh perspectives and a second tranche of pairs of eyes, are required. In contrast, we can see no strong reason for expecting major benefits to flow from the rigid separation of supervisory rule making from the kind of secondary decision making that occurs at the review stage (which itself chiefly serves a supervisory function).

#### *Appointment of members and recruitment of staff*

- (xiv) **The AEAA Chair and panel members should be appointed according to established criteria, and the panels selected for individual reviews by the AEAA Chair. The AEAA should draw core support staff from the AEMC, and supplement as necessary.**

The Panel recommends that AEAA members be selected on the basis of their knowledge and expertise in areas of most relevance to the types of decisions that will come before them. Relevant areas might include NSP management, engineering project management, auditing, utility finance, regulatory economics, and the practice of regulation. We specifically recommend weighting membership toward those with ‘know-how’ gained from experience of the practical operation of regulatory processes. Such know-how often enables skilled, experienced practitioners to get quickly behind the often bland and formulaic drafting of regulatory decision documents to the key sensitivities that can lie beneath, in much the same way as the skilled readers of Pravda and Izvestia used to be able to infer from the nuances of an official media what the Party Leadership was really up to behind the scenes. Indeed, probably the most effective way of keeping the resources applied to merits review limited is to appoint people with a nose for where the (metaphorical) bodies might be buried.

In addition, AEAA panellists should satisfy the various established criteria for the appointment of members of such bodies. Annex 3 below discusses these issues in more detail.

From this wider pool of AEAA panellists, it is suggested that, when a case arises, a review panel be established comprising five members. The selection of members of the review panel for each case should be made by the Chair, having regard to the nature of the likely issues that may feature in the specific matter.

#### *Funding of the AEAA*

The principal purpose of merits review is to achieve preferable decisions in the sense of decisions that better meet the objective of promoting efficiency in ways that serve the long-term interests of consumers. If NSPs are properly incentivised<sup>28</sup>, in the sense that their returns are linked, at least to some degree, to improvements in efficiency that contributes to consumer welfare, then both NSPs and consumers stand to gain from better decisions. The Panel recommends that those who benefit should pay, and specifically that:

- (xv) **The overhead costs of the review body should be shared among NSPs in proportion to their annual revenues, of which 50 per cent should be allowed as a recoverable cost in revenue determinations. The direct costs of the review body in individual cases should be borne in the first instance by NSPs, with the review body making a determination in each case as to the percentage of its costs that can be recovered on the basis of the assessed merits of the appeals made. Parties should bear their own, private costs.**

---

<sup>28</sup> The Panel recognises that this is currently a big ‘if’: there is a long way still to go in improving the alignment of NSP incentives with consumer welfare (the alignment that is achieved by competition in effectively competitive markets), particularly in relation to investment/capex incentives and (even more so) rewards for innovation.

The Panel recommends that, in order to ensure that the incentives for bringing an appeal are in line with the overall objectives of the NGO and NEO, that the AEAA have the discretion to determine whether the direct costs attributable to a review should ultimately fall on the shareholders or the consumers of the NSPs concerned, depending on the outcome of the AEAA's review. This could be done by first requiring payment from the NSPs involved, and later determining what proportion of that payment should be recoverable from customers via an increment to allowable revenue.

In addition, the Panel recommends that each interested party to an appeal should bear its own private costs associated with its participation in the appeals process. While this might be seen as maintaining a potential barrier to participation by some potentially interested parties – such as consumer or user groups – the effect will be mitigated to a substantial extent by the proposed change in the approach of the review process towards a more investigative one, in which consumers are invited to make submissions and, in the words used by the Panel in its Stage One Report, are no longer treated as inconvenient guests.

## **6. WIDER OBSERVATIONS ON THE REGULATORY REGIME AND POSSIBLE RULE CHANGES**

As part of its terms of reference, the Panel was asked to give consideration to possible amendments to other aspects of the NEL and the NGL and to the NER and NGR beyond those dealing with the LMR regime. In addition, the Panel was invited to comment on any other factors relevant to the operation of the LMR regime. This section sets out the Panel's observations on these wider matters, which are relevant because the merits review regime is only one aspect of a larger regulatory system, whose various constituent parts must work well together in order for the system itself to be effective. Indeed, one of the general concerns of the Panel is that the various institutions involved have not been working particularly well together, and that whilst improving the merits review aspects can be expected to help matters, the full benefits of these improvements will only be achieved if there is better co-ordination across the system as a whole, and if each institution has confidence in and accepts the legitimacy of the other institutions involved. It should be clear from the Panel's previous reports that it has found such confidence and legitimacy in fairly short supply.

We have also added some comments on network pricing and on supervision/scrutiny of expenditures on taxpayer and consumer funded environmental projects, for two reasons. First, these are areas where the difference between better and worse policies can amount to tens of billions of dollars. Second, in the face of rising energy costs, it is important that clear and truthful explanations be available to the public about the sources of rising costs and, more importantly, about where major upward cost pressures can be avoided, without significant harm to policy objectives, by more effective regulation. One of the major findings of the Panel has been that the existing LMR regime has been deficient in providing such explanations in relation to overall revenue/price determinations, and the same defect should not be painted on a wider canvas.

It should be noted that in relation to each of the points raised below, the Panel has only outlined its initial observations and has recommended that consideration be given to undertaking further work to explore each issue at the necessary level of detail. In this sense, these points differ, to varying degrees, from the more specific recommendations made in section 5 above.

### **6.1 Possible rule changes to improve the operation of the regulatory regime**

A principal conclusion of the Panel in its Stage One Report was that, given the relevant public policy objectives, the ultimate focus of merits review should be on the overall price/revenue determination, rather than the assessment of specific components (or constituent parts) of that decision. Whilst the Panel believes that the NER and NGR are

currently specified in ways that are consistent with such a focus, it was clear that, in practice, the rules had been interpreted by both the AER and NSPs to mean that assessments, including any assessments made at the appeal stage, were required to be conducted on a ‘bottom up’ basis, in which the overall revenue/price decision follows automatically from constituent decisions in relation to individual building blocks and to component elements of some of the building blocks (e.g. components of the cost of capital). The Panel considers that any remaining sources of ambiguity in the rules on this point should be removed, as it is firmly of the view that the prevailing ‘bottom up’ interpretation and application of the rules is inconsistent with best practice incentive regulation and with the Panel’s understanding of the intentions and objectives of energy policy.

Notwithstanding the AEMC’s current rule-change exercise, there seems to be considerable scope for continuing confusion in other parts of the rules, not least because the language used in parts of the NER and NGR. For example, words such as: ‘distribution determination’, ‘decision’, and ‘reviewable decision’ lack sufficient precision and/or are not used consistently. Similarly, the rules lack the required degree of clarity about how the NEO and NGO should be taken into account by the AER. Particularly given that it has been argued in the course of the LMR regime, that, when making revenue/price determinations, the AER is bound by the revenue and pricing principles of the NEL and NGL, rather than by the NEO and NGO, the leading roles of the NEO and NGO should be put beyond doubt.

**The Panel therefore recommends that the SCER request the AEMC to conduct a review of the rules with a view to achieving greater harmonisation with public policy purposes, as expressed in the NEL and the NGL, and with the Panel’s proposals for developing the merits review regime.**

More specifically, we suggest that the following principles be adopted:

**Enforceable decisions should be defined as decisions/determinations that have binding force on other parties, and, to avoid potential confusion, the word decision/determination should not be used in the rules for regulatory actions other than enforceable decisions/determinations.**

On this basis, decisions/determinations in relation to an overall revenue allowance are enforceable decisions, as would be the details of an incentive scheme that affected potential revenues, whereas a ‘decision’ about the appropriate level of revenue required to cover opex is not: an NSP is not required to spend the opex allowance on opex, or to spend no more than the allowance on opex. What are currently referred to as ‘constituent decisions’ in respect of individual building blocks are more accurately described as assessments that inform the regulator’s decisions. If the terms ‘decisions’ and ‘determinations’ were restricted to those that are here called ‘enforceable’, the language could be simplified: ‘enforceable decisions’ would become just ‘decisions’.

**In general, enforceable decisions should be reviewable.**

It may be the case that there are some regulatory decisions that have such limited impact that it is administratively expedient to remove them from the scope of review. These should, however, be exceptional cases.

**For the avoidance of doubt, the NER and NGR should restate the requirements of the NEL and NGL that the primary regulator is to be guided by the NEO and NGO, and to take account of the revenue and pricing principles when making revenue determinations.**

## **6.2 Consumer engagement in earlier stages of the regulatory process**

In its Stage One Report, the Panel identified lack of attention to the requirements of consumers as a general weakness of current regulatory arrangements. The proposals in this Report for development of the merits review regime should go some way to start to rectify this position at the appeals stage of the process, and we would expect them to have some influence on the extent to which consumer interests are taken into account in decision making at earlier stages. Further steps could also usefully be taken, to reinforce the shift in emphasis.

Specifically, the Panel considers that a greater focus on the long-term interest of consumers opens up greater possibilities for the development of stronger incentives for NSPs to be dynamically efficient. It is a particular limitation of CPI-X regulation as it is generally practised that it tends not to provide significant incentives for service innovations. Effective competition does much better, because it links the returns to the supplier to improvements in the welfare of the consumer.

Once it is accepted that, as Adam Smith put it, “*Consumption is the sole end and purpose of all production; and the interest of the producer ought to be attended to, only so far as it may be necessary for promoting that of the consumer. The maxim is so perfectly self-evident, that it would be absurd to attempt to prove it*”, the way is open for considering more creative ways of rewarding activities that achieve the desired ends.<sup>29</sup> Effective regulation that works well for consumers should also work well for suppliers, or at least for those suppliers who attend to their customers’ requirements (as in the case when markets are effectively competition competitive).

---

<sup>29</sup> *The Wealth of Nations*, 1776. We refer any reader who is under the misapprehension that making the long-term interests of consumers the touchstone of regulatory decision making is in any way inimical to the ability of reasonably efficient suppliers to earn a decent profit to the wider views of Smith, who is not known to have ever argued that governments should regulate prices at below cost, even in the face of public clamour to do so. Profit that is transparently earned by improving the welfare of consumers is the most legitimate form of profit, and hence tends to be the least vulnerable to the attentions of those who might be tempted to mandate unduly low prices.

As a matter of general principle, where feasible, regulation should seek to strengthen the positive linkage between improvements in consumer welfare and returns to suppliers. This is difficult to do in relation to pricing decisions themselves – in given (static) conditions, a lower price is good for consumers but bad for suppliers – but an innovation that increases the total economic benefit available allows for a desired positive linkage. Further work on benefit sharing schemes is therefore warranted, but the Panel thinks that there are some simpler steps that could be taken to encourage win-win outcomes potentially available from consumer-friendly innovations.

Specifically, **the NER and NGR could direct the AER to take account of NSP activities undertaken in the past period to seek out the preferences of customers/ consumers or of innovations that have led to demonstrable improvements in consumer welfare but that did not form part of previous revenue determinations.** The general notion is that the regulator should be aware that, where NSPs have made such efforts, an over-emphasis on setting revenues that are only just sufficient to cover costs would serve to weaken dynamic incentives, and, on that basis, might not be in the long term interests of consumers.

To reinforce this modest shift toward *ex post* rewards, a similar requirement might be placed upon the review body. That is, **when considering whether there is a materially preferable decision available, the AEAA should be explicitly required to take account of earlier efforts made to discover information about the requirements of consumers and efforts made to improve consumer welfare, over and above those contemplated in earlier regulatory settlements.**

The Panel does not recommend the establishment of a taxpayer-funded consumer advocate, of the type recommended in some submissions to its Review. The proposals for a more administrative, more investigative review process imply that the role of such an advocate would be a diminished one compared with what submitters contemplated, based on retention of the current, adversarial approach to review. Moreover, different consumers have different interests, and the Panel, based on its own experience, is of the view that the presentation of a variety of consumer perspectives is of assistance in investigative processes.

### **6.3 An independent AER?**

A recurring issue that has arisen in consultation with various stakeholders is the perceived lack of confidence in the capacity of the AER to perform its role as the primary regulator. In our Stage One Report we observed that the regulatory regime appeared to lack legitimacy with important stakeholders and that trust and confidence in the AER had not been established.

The situation to which this gives rise is an awkward one. The Panel is sympathetic to the notion that, given the likely challenges in the energy sector going forward, well used regulatory discretion is of potential benefit in facilitating necessary adaptations to changing

circumstances, and that over-constrained, rule-bound systems can become highly fragile in such circumstances (see, for example, the collapse of the Californian market reforms in 2000/01). The AER has consistently asked for more discretion (i.e. more power), including via the introduction of lighter touch supervision at the review stage, but there would be something perverse about granting more power to a regulator that has not yet demonstrated, to the satisfaction of others, that it can make good use of the powers that it already has. On balance, the Panel favours economic orthodoxy at this point: it is better to reward success than to reward failure.

**The Panel recommends that the issue of the AER's independence from the ACCC be revisited.**

During the course of its Review, the Panel heard views that, in consequence of the AER's position as a constituent part of the ACCC, the AER Chair and members are constrained in their ability to independently direct the development and utilisation of the organisational expertise and capabilities that are required for the effective performance of its role. The relevant points ranged from practical, administrative points such as limitations on the ability to direct organisational strategy and performance and to recruit and retain suitably qualified staff, to more fundamental issues such as the difficulties of reconciling a culture of 'continuous engagement' with stakeholders of the kind associated with contemporary utility regulation with the necessarily more arm's length culture that is appropriate to an enforcement agency such as the ACCC.

The Panel notes that there has been a long-standing debate (both in academic and practitioner circles) about the relative advantages and disadvantages of combining regulatory activities in different industries (and indeed competition law activities) within a single public agency. It also notes that both the findings and the recommendations of this Review may bring new evidence and new considerations to bear on the relevant trade offs.

In relation to the evidence, there appears to be a lack of constructive engagement between the regulator and the NSPs (as well as between NSPs and consumers) of a kind that is important if improved regulatory incentives are to be developed, particularly in relation to matters such as capex and innovation, which may involve commitments and payoffs extending over relatively long periods. A significant part of the incentive effects of regulation derive from the existence of an ongoing relationship between the regulator and the NSPs. For example, the longer-term relationship should, if it functions correctly, serve to discourage opportunism on both sides, and, since a vulnerability to opportunism is one of the weaknesses identified by the Panel in relation to the operation of the existing LMR regime, this may be an important consideration when thinking about issues of institutional design.

A second evidential point relates to what may be the strongest argument for the ACCC connection, namely the protection of regulatory decision making processes from pressures to be inappropriately swayed by the agendas of influential parties, including by what may be the fluctuating priorities of the government of the day. The debate on these points is often



expressed in terms of notions of ‘capture’ and ‘independence’, and the observation that the Panel makes is that the current ACCC connection does not appear to have prevented the AER, in the recent period, from making statements about electricity prices that are quite political in nature. If the aim is regulatory independence in the sense of ensuring that the relevant decision making, particularly where it has bearing on long term decisions such as those relating to network investment, is relatively immune to the short term vagaries of ever shifting media and political attention, the Panel’s sense of things is that the policy is not currently achieving that goal.

In the Panel’s view, it is independence from *unstable* political preferences that matters. Regulation itself is inherently political in nature, and there is nothing amiss in regulators reflecting settled political objectives in their decisions. Indeed, when those objectives are written into legislation, as they are in Australia (in the form of the NEO and the NGO), regulators must be guided by them. Arguments for ‘independence’ from stable political preferences should, we think, be approached with suspicion, since they tend to amount to a plea for greater bureaucratic power and/or reduced supervision and accountability in the exercise of power.

In relation to the Panel’s recommendations for the development of merits review, we note that these have potential implications for the capture/independence arguments. The proposals to establish a fully investigative review processes addresses the risk of capture problem directly, in a way that the current LMR regime does not. Industry ‘capture’, which becomes a greater risk if there is a strong working relationship between regulator and NSP of a type favourable to the mitigation of short-term opportunism, can be expected to manifest itself in overall revenue determinations that are tilted towards shareholders and against consumers. Compared with the *status quo*, the Panel’s recommendations provide enhanced protection against such an outcome, by allowing the AEAA to focus review directly on the overall revenue determination. Moreover, the greater access of consumer and user representatives to the review process means that they will be able to challenge AER decisions much more easily in the event that (in the future) there is a suspicion that relationships between regulators and NSPs have become too cosy. Similar remarks apply also in relation to circumstances in which regulatory decisions have been subject to inappropriate short term political influences.

With the greater protections against undue influences on regulatory decisions that are made possible by a less restricted merits review regime, there should be greater confidence that a self standing sectoral regulator should be able to operate effectively. In summary, the Panel is of the view that the evidence that it has heard, and the recommendations that it has made in relation to the merits review regime, combine to strengthen the case for AER independence from the ACCC.

## 6.4 Privatisation of NSPs

Another wider contextual issue that has arisen throughout the Panel's review is whether the regulatory system that is being applied in the energy sector – which is based on a variant of the CPI-X form of incentive regulation – is well suited to the ownership and governance structures that exist for the NSPs that remain under public ownership and control.

In the Panel's view the answer to this question is in the negative insofar as the regulatory system which is applied in the Australian energy sector is one that was principally designed for firms under private ownership, not public ownership, and that can be expected to be more effective (i.e. be capable of delivering more benefit to consumers) when applied to privately owned utilities. This is confirmed by some of the evidence that the Panel has seen which suggests (albeit in a fairly general way) that there appears to have been systematic differences in the way that publicly owned and privately owned NSPs have responded to similar revenue determinations (and hence to similar, regulatory-determined influences on incentive structures).<sup>30</sup>

These differences in the responses of publicly and privately owned NSPs are fully to be expected, since the overall incentive structures of NSPs are jointly determined by a range of influences, of which those aspects of incentives determined by the regulator are just one subset. For example, the requirements/preferences of owners or their agents, and the pressures placed on NSPs to meet those requirements/pressures, also contribute to the overall incentive structure, and in this context we note that the requirements/preferences that emerge from the governance structures of publicly owned NSPs tend to be relatively complex compared with those of their privately owned counterparts, for whom the emphasis is principally on financial returns. Given that some of these objectives are public/political in nature, there can be overlaps with regulatory functions, as well as the volatility/instability associated with changing political priorities.

Although this is a complex issue which raises a range of interrelated and difficult questions of both an economic and political nature, at a general level, there are at least two possible ways of addressing the potential mismatch between the regulatory system and the prevailing ownership and governance structures for many, but not all, NSPs. The first option is to give consideration to the possibility of the privatisation of certain NSPs with a view to sharpening the incentives on these firms to improve performance and deliver benefits to consumers under the current regulatory system. A second high-level option is to adapt the regulatory system in such a way as to develop different regulatory approaches for publicly owned NSPs and for privately owned NSPs. While this approach is potentially feasible, in the Panel's view it is fraught with major problems. To give just one example, since the governance arrangements for publicly owned NSPs may differ from state to state, the logic of the approach would be to tailor regulatory arrangements to the state-to-state differences in

---

<sup>30</sup> For example, capex out-turns relative to forecasts appear to be correlated with the type of ownership.

governance, but this would be in considerable tension with the wider aim of creating a regulatory structure appropriate for the oversight of a national electricity market.

It is also the Panel's view that the strengthening of the merits review regime should provide greater confidence in the case for privatisation of NSPs for those who might otherwise believe that public ownership provides some kind of extra protection for consumers. The Panel has seen no evidence of this, and believes that the long-term interests of consumers are better protected by effective regulatory arrangements than by ownership arrangements which inherently involve owners or their agents in managing conflicting objectives and interests. The Panel also points out, that under the existing and unsatisfactory LMR arrangements, some of the ACT reviews that led to significant increases in charges without any adequate account of how such higher prices could be expected to contribute to consumers' likely future welfare, have been instigated by publicly owned NSPs.

## 6.5 Pricing of network services

One of the concerns that has attracted increasing attention in the recent period is the upward pressure on electricity and (to a lesser extent) gas prices as a result of increasing network costs. The cost-of-capital decisions of the ACT, which the Panel addressed in its Stage One Report, were controversial because, other things equal, they could be seen as having contributed to higher network charges and upward pricing pressure in downstream energy markets. However, rather more substantial drivers of higher costs have been the combined effects of major investment programmes and the halt in demand growth caused by the global financial crisis, which, under the regulatory arrangements, implies that revenues are recovered from fewer units sold, and hence that per unit charges are higher than anticipated.

Notwithstanding the adverse impacts on consumers of the (unanticipated) financial crisis and (anticipated) higher investment programmes, it is possible to be confident that the current Australian regulatory system is, at least for privately owned utilities (and our reservations concerning its fit with publicly owned utilities is set out above), reasonably well designed to scrutinise investment going forward. There are improvements to be made, including to the merits review process, the ability to undertake a limited degree of *ex post* scrutiny of investment projects, the AER's capabilities, incentive arrangements, and certain aspects of the implementation of the CPI-X approach<sup>31</sup>, but these are incremental to a developed framework of assessment and cost control.

A potentially bigger impact on costs going forward lies in the development of more sophisticated forms of network pricing and demand management, which are increasingly facilitated by ever more sophisticated developments in information, communication and

---

<sup>31</sup> Since assets have long economic lives there is some flexibility to vary the time-path of cost recovery. Thus, it is not necessary to endure the current intensity of counter-cyclical movements in network charges – lower demand means higher charges – which those more familiar with competitive market conditions (where prices tend to fall when demand falls) often find hard to fathom, and not without reason.

control technologies. Network investment is heavily driven by peak demand, and economic pricing of network capacity would better reflect that fact. Given that the costs of demand shifting or demand reduction at the peak are often many times lower than the economic cost of providing incremental capacity, there are potentially large savings, perhaps extending into tens of billions of dollars, available from more sophisticated pricing and demand management.

In this context we note/recommend the following:

- Utility regulation is traditionally seen as being not only about determination of price/revenue levels (to cover costs) but also about price structures, among other things to encourage efficient use of existing assets. Peak pricing and demand management therefore fall four-square into the sphere of traditional regulatory responsibilities. **They should be priority areas for the AER.**
- Not least because of requirements for innovation (a matter not typically well handled by traditional regulatory approaches), progress is almost certainly likely to require extensive joint working on the part of the AER and NSPs, of a type we have indicated is required more generally to develop better incentives. **The Panel is of the view that this further reinforces the case for a re-examination of the AER's existing institutional positioning.**
- There are the usual distributional obstacles to change. More sophisticated network pricing can be expected to reduce average network charges, benefiting many, but may leave some groups worse off (e.g. those who find it most difficult to shift demand from high-priced peak periods). Regulators will need to find work-arounds for at least some of these distributional effects<sup>32</sup> if progress is not to be slowed by political factors. **Regulators and NSPs alike should not put their heads in the sand, ostrich like, and pretend that they are only required to think about efficiency. In reality, efficiency is more likely to be advanced if those involved think early and think clearly about distributional effects and how they can be addressed, since in that case politicians are likely to be presented with solutions rather than problems by the regulatory system.**

## **6.6 Scrutiny of public expenditure on environmental projects and schemes.**

Whilst the current regulatory system provides a sound base for scrutiny of expenditures and cost containment in network investment, albeit a base that is capable of significant improvement and refinement, the same cannot be said of the scrutiny applied to many aspects of environmental policy, particularly those connected with climate change policy. This is the case not just in Australia, but globally.

---

<sup>32</sup> For example, where low income households who spend a higher than average proportion of their budget might be particularly adversely affected.

Generally speaking, there are two major strands to climate change policies:

- Adoption of general economic instruments such as carbon taxes or emissions trading schemes.
- Support for a variety of *ad hoc* schemes, generally requiring public expenditure or subsidies paid for by higher consumer prices.

Both types of approach raise energy prices, but there is a crucial difference between the two. The first approach does not involve public expenditure or subsidies, but rather raises income for treasuries, which can be used for a variety of other purposes, including reductions in other taxes or measures to offset some of the adverse distributional impacts of the higher energy prices. There are, of course, political differences of opinion on such matters, but they do not involve the cost scrutiny issues familiar from utility regulation.

In contrast, the *ad hoc* schemes do raise cost scrutiny issues, since they involve public expenditures on particular projects or schemes. However, in relation to these expenditures, there is nothing like the regulatory system established to supervise energy network development and use. Systematic scrutiny against clear objectives is lacking, supervision tends to be chaotic, and the predictable consequence is avoidable waste, on a large scale.

We raise these points because, as noted at the end of the Stage Two Interim Report, there is an obvious danger that, in the face of rising energy costs, the Australian regulatory system might be blamed for the defects of inefficient decarbonisation programmes (of the *ad hoc* kind). And the risk then will be that the regulatory system will be undermined, rather than developed and strengthened.

**The Panel suggests that the right approach is to use what has been learned about cost scrutiny from the regulation of networks to inform cost scrutiny for environmental projects and schemes, so as to achieve environmental objectives at lower costs to energy consumers, both now and in the longer run. The wrong approach would be to let unsupervised environmental decisions undermine a basically sound, albeit far from perfect, approach to network regulation.**

No major country has yet succeeded in this task, but there is no reason Australia should not be the first.

## ANNEX 1: COST-BENEFIT ASSESSMENT OF PROPOSALS

The Panel's terms of reference includes a requirement to provide a cost and benefit analysis of any recommendations for change. The Panel has outlined its recommendations for change in the main sections of the report, particularly section 5, and the discussion in this annex outlines at a general level the various potential costs and benefits that the Panel perceives as being associated with its proposals. As the Panel has already indicated, it does not see this aspect of its task as involving attempted quantification, which for many aspects of the relevant issues is infeasible in any case. Rather, this Annex is intended to provide a first base for any regulatory assessment that might be undertaken in response to the Panel's recommendations.

In its July consultation paper on possible ways of adapting the LMR regime, the Panel explained that, in developing recommendations, the Panel was not minded to identify a limited number of options and then assess each against the others, including the *status quo* option. Rather, the Panel's preferred approach was to focus on the fact that the overall review framework was made up of a number of more elemental choices or decisions that combine to form the eventual whole. This suggested an approach which focussed on the examination of the individual features or characteristics of review processes, both individually and in possible combinations (of which there may, at least at the outset, be many), with a view to assessing whether adjustments would or would not serve to strengthen the effectiveness of the merits review regime, judged in terms of the NEO and NGO, and the wider framework of (electricity and gas network) regulation in Australia.

An immediate implication of the approach adopted by the Panel however is that there is not a set of different 'packages' of reform which can be assessed in terms of their costs and benefits. Rather there are a set of individual changes to the current LMR regime which cumulatively would, in the Panel's view, better contribute to the development of a review framework and set of arrangements that best meet the desired objectives of the NGO and the NEO.

Nevertheless, given what has been said about the aim of providing a first base for subsequent regulatory impact assessment, we will organise the material around comparisons of the Panel's recommendations with the *status quo*, judicial review only, and *de novo* review. Within this scheme of things, we include within the *status quo* category some of the more incremental suggestions for change that have been made by interested parties in the course of the Review. However, it should be noted that, upon examination, the Panel found there were major questions surrounding the feasibility of some of the suggested incremental adjustments, and that one of the major problems with which the Panel has had to wrestle has been uncertainty about the likely effectiveness of changes in addressing the problems identified.

## Summary of principal costs and benefits of Panel recommendations relative to the status quo

### *Costs*

- Loss of court-like, quasi-judicial procedures may have some effects on investor confidence.
- When they occur, individual appeals can be expected to be more resource intensive and costly.
- Possibly greater use of judicial review, in addition to review by the AEAA, than is likely to be the case under current arrangements.
- Higher overhead costs associated with expanded panel and enhanced resource inputs (although some proposed adjustments to the *status quo* also contemplate increasing the resource availability for reviews).
- When they occur, reviews will tend to be longer.
- Transitional costs of establishing a new review body.
- In the short term, investors may have less confidence in a new body such as the AEAA than they currently say they have in the ACT.

### *Benefits*

- Increased legitimacy of the process, with beneficial implications for regulatory certainty and investor confidence in the longer term.
- Will introduce normal merits review of the key regulatory decision – the overall revenue/price determination, hence providing the benefits associated with an increased likelihood of arriving at preferable decisions.
- Easier, lower cost access to the review process for consumer and user groups.
- Better translation of public policy intentions into outcomes.
- Mitigation of risks of gaming and excessive appeals activity.
- More effective accountability for final outcomes (the Chair will not face the same inhibitions as a judge in explaining matters to the public).
- Greater expertise and know-how brought to bear on complex decisions.
- New review body is expected to have a higher level of expertise in energy network regulation. Whilst the Panel acknowledges the vast expertise of the ACT in competition law and policy, it feels that energy network regulation, particularly in relation to price cap decisions, is a different beast.

## **Summary of principal costs and benefits of Panel recommendations relative to *de novo* appeals**

In the course of the Review the notion of *de novo* review seems to be given different meanings by different interested parties. The Panel here interprets it as meaning a review that sets aside all that has gone before and, in effect, considers matters again, from scratch. We assume that *de novo* review could be undertaken by the AEAA or by a similarly resourced tribunal, including possibly the ACT working with enhanced resources.

### *Costs*

- The perspective of the ‘second pair of eyes’ looking at the problem is less independent of that of the primary regulator (since the recommendations require the AEAA to start from the primary regulator’s ‘record’), implying a possibly higher persistence of poor judgments, biases and errors.
- Possibly greater use of judicial review, in addition to review by the AEAA than would be the case under *de novo* arrangements.
- Since limitations are set on the level of review activity – for example, by focusing only on reviews that can be expected to lead to *materially* preferable decisions – some opportunities for improvement of decisions will necessarily be foregone.

### *Benefits*

- Closer to existing arrangements in that the recommendations are based upon assessments that are incremental to the work of the primary regulator, giving rise to less short-term uncertainty.
- Significantly lower costs, since the AEAA does not have to replicate the AER’s previous work.
- Makes productive use of the work of the primary regulator.
- Shorter durations of review.
- Reduces the problem of participants withholding information at the primary decision making stage, or of treating the earlier stage lightly in the expectation that everything that happens at that stage will eventually be binned.

## **Summary of principal costs and benefits of Panel recommendations relative to judicial review only**

### *Costs*

- Individual reviews will be more resource intensive, and hence costlier.
- Since parties will still be able to apply to have decisions judicially reviewed, there is the possibility of multiple appeals, adding to costs and delays.



- The AEAA would inhibit the development of the ‘enhanced judicial review’ that some parties favoured and expected to occur if judicial review were the only review activity.

### *Benefits*

- Judicial review, even if enhanced, is less likely to lead to the discovery of preferable decisions than merits review, including merits review subject to resource constraints.
- Related to the above, less effective supervision of the discretionary actions of the primary regulator, implying less ability to correct for undue influence on, or capture of, agency decision making.
- Replacement of adversarial processes that are not necessarily well suited for dealing with decisions with multiple possible outcomes, and that can serve as a barrier to participation for some interested parties.
- More resources and more technical expertise available for information-intensive assessments.
- The new review body is expected to have a high level of expertise in energy market regulation. This expertise is more appropriate to the task of reviewing regulatory determinations than the legal expertise of the Federal Court.

### **Other comments**

As already explained, the Panel did not develop its proposals by way of the above comparisons, but rather by an incremental process in which higher benefit, lower cost adjustments were made in relation to a variety of issues and questions that were raised. One factor that is not clearly revealed by the above summaries is the underlying risk assessment. As stated, a number of proposals were put before the Panel that, when explored, seemed to involve high levels of uncertainty, in the sense that it was difficult to conclude that they would have the claimed effects. Put another way, the claimed effects seemed speculative and unsubstantiated, and there appeared to be obvious, associated risks of unintended consequences. A number of the difficulties here have echoes in the more general debate about Australian tribunals, outlined in Annex 2 of this Report.

It weighed heavily with the Panel that its recommendations for a more investigative form of merits review are akin to arrangements that operate effectively in jurisdictions overseas. On the basis of this wider experience, it is possible to be reasonably confident that the arrangements will deliver outcomes consistent with policy intentions to a degree that has proved beyond the reach of the current LMR regime. For reasons given, the Panel believes that there can be little confidence that the desired outcomes can be delivered by minor adjustments to the existing arrangements. Moreover, the existing arrangements themselves appear to the Panel to be becoming increasingly fragile over time (for reasons given in our

various reports) as pressures mount on the regulatory system in the fact of upward cost and pricing pressures.

Although any change almost inevitably raises the level of regulatory uncertainty for a time, we believe the magnitude of the relevant effects will be relatively limited and their duration relatively short. Administrative review of administrative decisions of the type contemplated is a known quantity, with an established record in other jurisdictions of promoting regulatory certainty and investor confidence. Nothing in the Panel's proposals weakens the rights of NSPs to seek judicial review of regulatory decisions, including judicial review in the event that the AER fails to comply with the NER and NGR or with the revenue and pricing principles of the NEL and NGL, including that section of the principles dealing with the protection of NSP property rights. The Panel's recommendations have the effect of *strengthening* NSP protections against what general economic research evidence on regulation suggests is probably the major perceived risk to investor returns going forward, namely the systematic use of multiple, available discretions to tilt regulatory decisions in favour of lower prices for political or 'presentational' reasons. The existing LMR regime provides little or no protection against such tendencies; the Panel's recommendations do.

## ANNEX 2: THE DEBATE ABOUT TRIBUNALS

One of the principal recommendations of the Panel is that the review powers which currently reside with the Australian Competition Tribunal (ACT) be transferred to a new body (the Australian Energy Appeals Authority (AEAA)) which is more administrative, and less court-like, in nature. Before arriving at this recommendation, the Panel considered carefully the question of whether it might be possible to adapt the structure, processes and procedures of the ACT in such a way so as to be able to accommodate the various recommendations we have made concerning the desirable characteristics of the review process, including the recommendation that the review body be more investigative in nature.

In considering this potential to adapt the ACT to be more investigative, and less adversarial, in its approach, the Panel considered the wider literature and research on the operation of tribunals as review bodies in the Australian context. To its surprise the Panel discovered that there has been a debate for many years about the extent to which tribunals – particularly the Administrative Appeals Tribunal (AAT) – can be operated in ways which are less adjudicative, more inquisitorial/investigative and less court like in nature. While the Panel did not rely on material from this debate in reaching its conclusions about the desirable characteristics of a merits review body, it has influenced the Panel’s thinking about the potential risks, uncertainties and unintended consequences likely to be associated with attempts to reform the ACT to give that institution characteristics that are better adapted to the review of revenue/price control decisions. This Annex therefore notes some of the more important issues that have been raised in research and discussion on Australian administrative tribunals.

### *Australian administrative tribunals*

At a general level, the role and functions of tribunals such as the AAT are relatively clear. Under the constitutional separation of powers it has long been acknowledged that tribunals are to be regarded as part of the administrative/executive branch of government, and cannot be established as courts.<sup>33</sup> Moreover, the High Court has concluded that although proceedings before tribunals such as the AAT may at times appear to be adversarial, the substance of the review is ‘inquisitorial’ and the AAT is an administrative decision maker which is under a duty to arrive at a correct or preferable decision in the case before it and according to the material before it.<sup>34</sup> Furthermore, and as a consequence of this, the High Court has ruled that “[t]he notion of the onus of proof which plays so important a part in

---

<sup>33</sup> The 1971 Kerr Committee report determined that courts could not provide merits review of administrative decisions, and recommended the creation of a peak merits review tribunal to undertake such a task. See Cane P (2009) *Administrative Tribunals and Adjudication* (Hart Publishing Oxford) page 85.

<sup>34</sup> *Bushnell v Repatriation Commission* [1992] H.C.A 47; 175 CLR 408.

*fact-finding in adversarial proceedings before judicial tribunals, has no part to play in these administrative proceedings”.*<sup>35</sup>

In practice, however, although tribunals are supposed to be ‘inquisitorial’ in their approach, many commentators and surveys have concluded that such an approach has been largely rejected in practice. Professor Robin Creyke of the Australian National University (ANU) has been reported as noting, for example, that “*Australian Tribunals were designed to operate in an inquisitorial manner by statute, yet courts and tribunals have been reluctant to set up, sanction or even promote alternative modes of process beyond those with which they are most familiar*”.<sup>36</sup> Another commentator has recently noted the “*hesitancy with which the inquisitorial mode of operation has been embraced by tribunals*”, and concluded that “[t]he adversarial operation of tribunals was condemned early in the life of the modern administrative tribunals, and remains an ongoing source of criticism”.<sup>37</sup> Finally, in their conclusion to a detailed survey of inquisitorial processes in Australian tribunals, Bedford and Creyke make the claim that “*generally speaking tribunals do not operate in an inquisitorial fashion. The culture of adversarialism in Australia is too strong for an alternative mode of procedure to be adopted*”.<sup>38</sup>

A number of reasons have been suggested for this reluctance of tribunals to accept an inquisitorial role. One factor identified is that the courts may have inhibited tribunals from taking a more interventionist role, by adopting an ambivalent attitude to what a ‘duty to inquire’ means for tribunals when conducting merits review (a duty to inquire has been framed around the standard of not failing to make inquiries which no reasonable administrative decision maker would have failed to make).<sup>39</sup> Put differently, there is ambiguity regarding the extent to which tribunals, when conducting merits review, are required to conduct inquiries into issues which are critical to a decision.<sup>40</sup>

---

<sup>35</sup> Bushnell v Repatriation Commission [1992] H.C.A 47; 175 CLR 408.

<sup>36</sup> Jacobs L, Baglay S and others (2011) ‘The Nature of Inquisitorial Processes in Administrative Regimes: Global Perspectives Research Workshop Report’ Canadian Journal of Administrative Law and Practice, vol. 24, page 268

<sup>37</sup> Smyth M (2010) ‘Inquisitorial Adjudication: The Duty to Inquire in Merits Review Tribunals’ Melbourne University Law Review, Vol. 34, page 261.

<sup>38</sup> Bedford N and Creyke R (2006) ‘Inquisitorial Processes in Australian Tribunals’ The Australia Institute of Judicial Administration, page 64.

<sup>39</sup> Jacobs L, Baglay S and others (2011) op cit, page 268; Bedford N and Creyke R (2006), op cit, page 38. Generally, see Smyth M (2010), op cit.

<sup>40</sup> This ambiguity was highlighted in one Federal Court decision (*Sullivan v Department of Transport*) where Deane J said for example that: “*Circumstances may, of course, arise in which a statutory tribunal, in the proper performance of its functions, will be obliged to raise issues which the parties do not wish to dispute and to interfere, either by giving guidance or an adverse ruling, with the manner in which a particular party wishes to present her case. Ordinarily, however, in the absence of a request for assistance or guidance by a party who is appearing in person, a tribunal under a duty to act judicially should be conscious of the fact that undue interference in the matter in which a party conducts her case may, no matter how well intentioned, be counter-productive and indeed, even overawe and distract a party appearing in person to the extent that it leads to a failure to extend her an adequate opportunity to present her case.*” In a more recent High Court decision, however, Kirby J in his dissenting opinion noted that “*A Tribunal member with obligations to perform his functions in an inquisitorial manner, failed to elicit facts relevant to the exercise of the tribunal’s jurisdiction*”. In another decision (*Applicant VEAL of 2002 v Minister for Immigration and Multicultural and Indigenous Affairs [2005]*) the High Court concluded that tribunals are under an obligation to be satisfied that their decision

On this point, Bedford and Creyke observe that: “[t]he absence of clear guidance as to when such an obligation of inquiry arises has created difficulties for tribunals. There was clearly a dissonance between the notion of a tribunal with a duty to be satisfied that it had made the correct or preferable decision, and the absence of any obligation on the tribunal to seek further information in order to reach that state of satisfaction.”<sup>41</sup> Furthermore, they argue that this issue has highlighted the ‘awkwardness of a system’ where the decisions of an inquisitorial tribunal are subject to review by courts which are operating on the basis of procedures that are adversarial in nature.<sup>42</sup> Indeed, Bedford and Creyke go so far as to conclude that this “systematic fault line has undermined the intentions behind the adoption of the inquisitorial model”.<sup>43</sup>

A similar observation about the impact of judicial oversight on the operation of tribunals was made in a 2006 paper by the then Commonwealth Ombudsman, Professor John McMillan. His conclusion, which reflects the impact of three decisions of the High Court on tribunals, was that “the development of the tribunal system in Australia is unduly constrained by legal paradigms”.<sup>44</sup> Indeed, former Presidents of the AAT confirm that tribunals, such as the AAT, have consciously adopted the ‘judicial’ model. For example, Sir Gerard Brennan, the first AAT President, readily acknowledged that the AAT had followed a judicial rather than administrative model, while his successor Deidre O’Connor, noted the ‘inescapable fact’ that bodies such as the AAT exist within the Australian legal system and its practices and procedures have developed within those norms. She notes: “The AAT is a legal institution and attempts to remove all traces of legal culture and procedure would be an unnecessary and disproportionate response to perceived adversarial bias”<sup>45</sup>

Cultural elements have also been held to hinder tribunals in their attempts to adopt a more inquisitorial role. It has been noted for example by some commentators that in “a common law adversarial context like Australia, interventionist policies have been likened to bias. It can also be difficult on a practical day-to-day level, for lawyers trained in the adversarial system to adapt to informal tribunal hearings”.<sup>46</sup> In an influential 1982 assessment of inquisitorial procedures, Gillian Osborne raised a similar point noting that: “[t]he common law view that judges should not descend into the arena lest their vision be clouded by the dust of conflict may account for the reluctance of some Administrative Appeal Tribunal members to take a more inquisitorial approach”.<sup>47</sup> The 2006 survey by Bedford and Creyke

---

is ‘correct and preferable’, and in the words of Bedford and Creyke “[i]n order to achieve that state of satisfaction the tribunal may need to make further inquiries”. Bedford N and Creyke R, op cit, page 43.

<sup>41</sup> Ibid, page 41.

<sup>42</sup> Ibid, page 42

<sup>43</sup> Ibid, page 42.

<sup>44</sup> McMillan J (2006) ‘Administrative Tribunals in Australia – Future Directions’ Paper delivered to the International Tribunals Workshop, page 1.

<sup>45</sup> O’Connor D (1999) ‘Appearing before the AAT: A non-adversarial approach’ New South Wales Bar Association Seminar, 10 May 1999, page 1.

<sup>46</sup> Jacobs L, Baglay S and others (2011), op cit, page 268.

<sup>47</sup> Osborne G (1982) ‘Inquisitorial Procedure in The Administrative Appeals Tribunal – A Comparative Perspective’ Federal Law Review, col 13, page 172.

made the point more sharply noting that: *'to judges trained in adversarial methods the level of questioning required in an inquisitorial process may indicate bias'*.<sup>48</sup>

In a recent analysis Mark Smyth observes that general jurisdiction tribunal hearings often resemble adversarial court procedures, and that a 'culture of adversarialism' in tribunal procedures remains in all the major Australian tribunals. He attributes this fact to various 'systemic pressures' which curtail the operation of the inquisitorial approach. These pressures include: *"the general application of the rules of evidence out of pragmatic convenience and historical significance; concerns over ostensible bias; the organisational leadership of tribunals by judges or senior lawyers; the use of legal counsel and a pervasive adversarial legal culture; the location of tribunals in a system in which ultimate review is in an adversarial court proceeding; resource limitations; and the objective that tribunals be 'fair, just, economical, informal and quick'"*.<sup>49</sup>

Other commentators have suggested that the reason why tribunals have not been as proactive as they could have been in terms of using their inquisitorial/investigative powers is because of resource limits, and in particular, the lack of staff to find witnesses or investigate other evidence.<sup>50</sup> Relatedly, as numerous commentators have noted, tribunals are usually established to fulfil particular objectives including making expeditious decisions at lower costs than the courts. It is argued that these so-called 'managerial requirements' for speed and cost efficiency may have encouraged tribunals to be less investigative/inquisitorial than they would otherwise have been. This can create a tension between the provision of probing, inquisitorial adjudication and the need to provide speedy and cost effective access to justice.<sup>51</sup> As Smyth observes on this point: *"Because efficiency legitimises the existence of tribunals, managerial considerations have had significant implications for the depth of merits review and the willingness of courts to impose positive obligations via a duty to inquire"*.

Bedford and Creyke make the more general observation that a common objective in establishing tribunals in Australia has been to manage large number of disputes *'more cheaply and efficiently'* than the courts.<sup>52</sup> On this basis they draw an important implication about why it is that tribunals were given inquisitorial powers in the first instance: *"The emphasis on speed, informality, and economy suggests that the principal motivation for giving the tribunal inquisitorial powers was not because of a belief in the truth-elicitation*

---

<sup>48</sup> Bedford N and Creyke R (2006), op cit, page 1

<sup>49</sup> Smyth M (2010), op cit, page 237 and 241.

<sup>50</sup> Asimow M and Lubbers J (2010) 'The Merits of "Merits" Review: A Comparative Look at the Australian Administrative Appeals Tribunal' (quoting Professor Cane) Windsor Year Book of Access to Justice, vol 28 (2) page 276; Bedford N and Creyke R, op cit, page 62.

<sup>51</sup> Smyth M (2010) op cit, page 234. See also Lindgren J observations on these various objectives in *Sun Shan Qui v Minister for Immigration and Ethnic Affairs*, (later approved by the High Court in *Minister for Immigration and Multicultural Affairs v Eshetu* ) where he noted: *"First, the objectives referred to in [s] 420(1) will often be inconsistent as between themselves. In particular, a mechanism of review that is 'economical, informal and quick' may well not be 'fair' or 'just'."*

<sup>52</sup> Bedford N and Creyke R, op cit, page 8.

*advantage of the civil law model, but rather to ensure an efficient and relatively speedy resolution of complaints. The choice was pragmatic rather than principled.*"<sup>53</sup>

In his detailed comparative analysis of the role and performance of administrative tribunals Professor Peter Cane of the ANU urges a movement away from the debate about whether or not tribunals should be inquisitorial or adversarial, on the basis that these terms are imprecise and lack agreed meanings. Rather he proposes that any analysis should focus on the respective roles of reviewers, applicants and respondents. In relation to the reviewers' role, he suggests a useful distinction between 'active' and 'passive' review, and in this respect discusses the issue of how active tribunals should be in the collection of evidence. In discussing the notion that tribunals are not bound by the rules of evidence, he notes:

*From this perspective, the rule can be explained as a corollary of the idea – made most explicit in the Australian concept of merits review – that the function of non-judicial administrative adjudication is to ensure that the 'correct or preferable decision' is made, not to identify errors in the primary decision (making process)...the prime function of the reviewer is not to choose between the arguments of a proponent and an opponent of a decision but rather to decide what the correct or preferable decision would be.*<sup>54</sup>

One consequence of this point, however, is that the mixed structure of adversarial and inquisitorial approaches that have been adopted by tribunals has led to some uncertainty about the respective responsibilities of the parties and the tribunal in adducing evidence. It can be asked, for example: to what extent does the reviewer carry the responsibility for collecting evidence? On this point there is active debate, although it has been suggested that the use of broad guidelines setting out the basic responsibilities of the tribunal and the parties can be important in promoting the application of a more inquisitorial/investigative approach, particularly in instances where there are a number of different members who sit as the tribunal for different matters.

### *Comments*

The above discussion highlights some of the issues that have been raised in the wider literature on the purposes and operation of tribunals. The overarching message that the Panel has taken away from this work is that, although in principle Australian tribunals are expected to be more inquisitorial/investigative (or less adversarial) in conducting reviews, in practice there are a number of factors which appear to limit the ability of tribunals to behave in such a way. These include the influence of the legal mindset in the establishment and operation of tribunals, the place of tribunals within the legal architecture, ambiguity about the extent to which tribunals should make their own inquiries, issues associated with specialist skills and resources, possible conflicts between the objectives of providing speedy and cost-efficient

---

<sup>53</sup> Ibid.

<sup>54</sup> Cane P (2009), op cit, page 240.

decisions and the need to make sufficient inquiries to ensure that the ‘correct or preferable’ decision is made; and finally a series of wider cultural factors.

In terms of implications for its own work, an inference that the Panel has drawn from the wider discourse about Australian merits review tribunals is that their operation is subject to a number of persistent influences which it would be exceedingly difficult to change by means of the kinds of measures that could be introduced in the context of reforming the merits review arrangements for electricity and gas networks. A number of these influences would appear to be inimical to the kind of developments that the Panel believes are necessary to address the problems with the existing LMR regime which have been identified.

The general picture is consistent with more specific evidence collected as part of the Panel’s own inquiries. We heard, for example, how in the past the ACT has itself attempted to make its proceedings less adversarial, and how that attempt was thwarted. At best, therefore, the prospects for the success of ACT reform appear to the Panel to be uncertain, more likely they are poor, and beyond this the Panel has not found it necessary to go. Since (i) a viable, non-adversarial, institutional framework for review is available, and (ii) the alternative approach avoids the inimical influences discussed above, and therefore avoids the risks and uncertainties to which they give rise, it suffices for us to conclude that the risks of failure that would be associated with attempted ACT reform are significant, which, on the basis of the available evidence, we have had no difficulty in doing.



## **ANNEX 3: POSSIBLE ORGANISATIONAL AND ADMINISTRATIVE ARRANGEMENTS FOR ESTABLISHMENT OF THE AEAA AS AN INDEPENDENT CONSTITUENT PART OF THE AEMC**

### **A. 3.1 Functions of the AEAA**

The functions of the AEAA are outlined as recommendation (v) in section 5.1 and are repeated here for context. In summary, the Panel recommends that the main activity of the AEAA when a review is launched be investigatory in nature. This preference for an investigative approach is linked to the nature of the decisions being made. The objective should be to ‘discover’ the most preferable price/revenue decision, against the relevant statutory objectives and the pricing principles.

To give effect to this investigative approach the Panel recommends that the AEAA be given specific duties, among which should include the following:

- To decide whether a ground for review has been established, and, if so, to open a review. (One obvious question, among others, would be: has there been a ‘howler’?)
- Adopt the ‘record’ of the primary decision maker as the starting point for its own review (hence the review would not be *de novo* in the sense of starting again).
- Supplement the record with evidence from its own investigations where considered appropriate.
- Invite all interested parties to give views.
- Decide whether a materially preferable decision is available.
- If it is, substitute a materially preferable decision, or remit matters back to the AER for further consideration.
- Make decisions in relation to the allocation of costs.
- Publish guidelines on the AEAA procedures, particularly so as to assist interested parties in the first years of the new arrangements. The guidelines might cover matters such as principles for cost allocation, the circumstances in which an interested party would typically be given its own hearing, circumstances in which there would tend to be substitution of decisions rather than remittal, when public hearings might be held, etc.) Some of the content of the guidelines should be

directed toward limiting the scale of the investigations – e.g. explaining that not every participant could expect a hearing, detailed repetition (rather than summaries) of evidence already on the record could be treated as vexatious, and so on.

### **A. 3.2 Guiding principles for establishment of AEAA**

#### *General principles for establishment of the AEAA*

The AEAA panel should be composed of a significant number of members (up to say around fifteen) with regulatory, energy market and other relevant experience drawn from backgrounds including commerce/business, government policy, economic regulation, finance/accounting, engineering, legal, etc. It is the Panel's view that key criterion for the appointment of members to the AEAA panel would be experience, since it will be necessary for reviewers to be able to 'see through' large quantities of information to test for potential defects in decision making, and such skills are normally associated with the know-how acquired from having undertaken, or been otherwise involved in, similar exercises in the past. Furthermore, as the AEAA must be able, and be seen to be able, to conduct its reviews and make its decisions independently of the AEMC, and of inappropriate political influence, it will be important to avoid potential conflicts of interest in constituting the AEAA panel.

In terms of processes and procedures, the Panel recommends that the AEAA be sufficiently resourced to be able to conduct reviews that potentially reach any aspect of the relevant regulatory decision, and that it base its work on open accessible processes and investigations. This will require that the AEAA have access to sufficient staff and/or consultant resources with the necessary knowledge and experience to support its investigations, analysis and decision-making. Ultimately, however, all decisions of the AEAA must be decisions of those sitting on the review panel, and not those of supporting staff and consultants.

In terms of institutional and governance arrangements, it is the Panel's recommendation that the AEAA be headed by a part time Chair, supported by two part time deputy Chairs, to provide leadership, chairmanship and oversight of the AEAA's decision review and administrative functions. The AEAA should have the support of a Director/Secretary, and the administrative and system support arrangements required for the management of its budget, payments for costs incurred and related financial arrangements and administration of its review processes.

In terms of financing, for the reasons stated in earlier sections of this report, the Panel is of the view that the AEAA should have access to an adequate budget for the performance of its function, to be funded in the first instance by appropriate levies/charges on energy network businesses, part of which could be recoverable from adjustments to revenue/price determinations. Consistent with normal practice, the AEAA should be accountable for its performance and use of funds, should have its administered accounts audited, and should to publish an annual report on its activities, performance and finances

Finally, the Panel recommends that the AEAA's performance and effectiveness in meeting the expectations of policy be subject to independent review and report to SCER every five years.

#### *Relationship between the AEAA and the AEMC*

As outlined in section 5.2, the Panel recommends that the AEAA be attached to the AEMC, and this raises the question of the nature of relationship between the AEAA and the AEMC.

The Panel recommends that the AEAA be fully independent of AEMC in conducting reviews and in making decisions. Although the AEAA Director/Secretary should be employed and provided with HR support by the AEMC, the Director/Secretary should not be subject to AEMC direction or guidance in the performance of management and support functions for the AEAA.

In terms of the staff available to work on particular matters and other resource issues, the Panel recommends that the AEMC provide the AEAA with access to staff with relevant skills and experience for particular matters, including temporary staff seconded for the specific purpose of assisting with review, arrange contracting with consultants as necessary and provide administrative system and back office support services.

Finally, in order to facilitate consistency between *ex ante* (rules) and *ex post* (review) of regulatory decisions, the AEAA Chair and Deputy Chairs should meet with AEMC Commissioners regularly (say on a six monthly basis) to provide two-way feedback on how the regulatory governance arrangements are working, and to discuss issues that may have implications for the balance between *ex ante* and *ex post* supervision. In addition, the CEO of the AEMC and the Director/Secretary of the AEAA should also maintain regular communication with AEMC Commissioners and staff on the staffing, administrative support and financial aspects of the relationship.

#### *AEAA relationship with SCER*

As indicated above, the Panel recommends that the AEAA be directly accountable to SCER for its performance, and should be subject to five-yearly reviews of its performance and effectiveness.

### **A. 3.3 AEAA appointments process and cost recovery**

#### *Appointments to the AEAA panel and to panels for specific reviews*

As discussed at A.3.1 above, the panel members of the AEAA should be appointed on the basis of merit using an independent search and interview process.

It is the Panel's view that the Chair and Deputy Chairs should be recommended and appointed using the Protocol for Appointment to Energy Market Governance Institutions and Panels. While the remaining panel members could also be appointed using this process, in view of the numbers involved (possibly up to fifteen), it may be more efficient to have the AEMC approve those appointments in conjunction with the AEAA Chair following a selection process run either by the AEMC or the Protocol appointments panel.

For individual reviews, the AEAA Chair should determine the membership of the review panel having regard to the matter being reviewed and the experience and knowledge required.

#### *Appointment and direction of Director/Secretary*

The Director/Secretary of the AEAA should be appointed by the AEMC as a member of staff in consultation with the AEAA Chair. However, as indicated above, although the Director of the AEAA should be appointed by the AEMC, once in position he/she should not be subject to AEMC direction in performance of support functions for the AEAA but provided with normal human resources support and services by AEMC.

#### *Staffing support for individual AEAA reviews*

As already indicated, the staff to assist in a particular review should be provided by AEMC on an as needs basis. Where appropriate, secondments could be arranged for the duration of particular reviews.

In terms of the use of specialist legal and consultant advice, it may be most efficient if the contractual arrangements are made with the AEMC on behalf of the AEAA (assuming it is not a legal entity). Administrative support systems and back office functions should also be provided by the AEMC. These services as well as staff support and contracted consultant/legal services would be provided to the AEAA on an actual cost recovery basis.

#### *Budget funding and cost recovery*

The AEAA should be given an adequate budget for the performance of its functions and to pay for the costs incurred including remuneration of panel members and reimbursement of AEMC for services provided.

In general terms, it is the Panel's view that those who benefit from the merits review process should pay. A recommendation for how costs might be allocated, and how the allocation process might be used to provide directional incentives on participants, is set out at (xv) of section 5.2. However, the specific mechanism used for cost recovery, its legal basis and associated administrative arrangements, are matters for further analysis and policy consideration, and other alternatives would clearly be possible.

*Stewardship, due diligence and transparency*

The AEAA should be accountable to the AEMC for stewardship and due diligence in its use of resources and funds. In this respect the AEAA should maintain administrative accounts which are audited and published annually. The AEAA should also be required to publish an annual report on its activities, performance and financial position.

## **ANNEX 4: TERMS OF REFERENCE**

### **Review of the limited merits review regime in the National Electricity Law and National Gas Law**

#### **Background**

A limited merits review regime was introduced into both the National Electricity Law (NEL) and the National Gas Law (NGL) in 2008.

The regime allows parties affected by prescribed decisions to have those decisions reviewed by the Australian Competition Tribunal (the Tribunal) where it can be established that there is a serious issue and grounds for review.

In its 2006 Decision Paper, *Review of decision-making in the gas and electricity regulatory frameworks* (the MCE Decision Paper), the Ministerial Council on Energy (MCE) – now the Standing Council on Energy and Resources (SCER) – agreed to a review of the effectiveness of the merits review regime within seven years of its commencement (the Review).

This requirement is given legislative recognition in the NEL and NGL (see sections 71Z and 270 respectively). On 9 December 2011, the SCER agreed that the Review should be brought forward to commence ahead of the seven year timeframe, in light of increasing concerns surrounding the operation of the regime in practice.

The purpose of the Review is to assess the effectiveness of the merits review regime under both the NEL and the NGL since its introduction in light of the MCE's original policy intention reflected in the MCE Decision Paper, and to advise on what if any amendments or restructuring of the limited merits review framework are required.

The Review will be undertaken in two stages:

- a Preliminary Review to assess the performance of the regime; and
- a report on whether any changes to the regime are necessary.

The Review is required to conclude by the end of September 2012, in order to provide sufficient time to introduce any legislative changes into the South Australian Parliament (the lead legislator for amendments to the NEL and NGL) prior to the Final Determinations for the next round of regulatory resets in April 2014.

On 3 November 2011, the Australian Energy Market Commission (AEMC) initiated a Rule change process for the *Economic Regulation of Network Service Providers*. Given the significant interdependencies between the subject matters of that Rule change process and this Review, the consultant will also be required to engage with the AEMC throughout the Review process.

## **Approach to the Review**

The intention of the Review is, ultimately, to provide advice to the SCER about what, if any, changes are required to the avenues for appeal available to energy network businesses to deliver the National Electricity Objective (NEO) and the National Gas Objective (NGO). Consequently, the assessment framework for this Review is the NEO and NGO, as set out in the NEL and NGL respectively, and the revenue and pricing principles set out in the underlying Rules.

### *Stage One*

The intention of Stage One of the Review is to provide an overview of how the limited merits review regime has operated to date in both the electricity and gas sectors, and the extent to which policy outcomes reflected in the MCE Decision Paper have been achieved. The consultant, or another party to be appointed after discussion with the consultant, will:

- report on the outcomes of the current merits review regime to date;
- examine its effectiveness in achieving the original policy intent;
- provide a high level overview (in tabulated form) of comparable appeal mechanisms in Australia and overseas;
- consult with stakeholders; and
- engage regularly with the SCER's Senior Committee of Officials (SCO) and the AEMC.

Following consideration of the preliminary report, the SCER SCO will release the Stage One Report publicly, as this will form the basis of the analysis required in Stage Two.

### *Stage Two*

The intention of Stage Two of the Review is to provide advice to the SCER about whether changes to the avenues for appeal available for network businesses are required to deliver an appropriate balance between the commercial needs of the businesses and efficient outcomes for consumers, consistent with the NEO and NGO. The consultant will develop a Final Report that:

- in light of the findings in Stage One, determines if the current limited merits review model is providing the appropriate balance between the objectives of facilitating necessary investment and minimising cost to consumers;
- provides recommendations on appropriate next steps for SCER consideration, including whether any amendments to the regime and any associated rule changes should be considered; and
- provides a cost and benefit analysis of any recommendations.

After consideration of the Final Report's recommendations, the SCER will provide its response to the recommendations in the final report, including any potential legislative and rule changes should this be recommended.

## Scope of the Review

### *Stage One*

In undertaking Stage One of the Review the consultant, or a party appointed after discussion with the consultant, is required to provide:

1. A high level overview of how the current limited merits review regime in the NEL and NGL has operated since its introduction in 2008. This will include:
  - a. as contextual information, a summary, in tabulated form, of the matters that have been appealed including<sup>55</sup>:
    - i. the elements of decisions that were appealed,
    - ii. the ground/s of review under which decisions were appealed,
    - iii. the findings in relation to decisions that were appealed,
    - iv. a comparison of the Tribunal's findings with the positions of the Australian Energy Regulator (the regulator) in its regulatory determinations (before appeal), and
    - v. any revenue changes involved and the price impacts on end-users;
  - b. a summary of decisions the Tribunal has made in exercising its discretion under Division 3A of Part 6 of the NEL and Divisions 2-4 of Part 5 of Chapter 6 of the NGL, including discretion relating to: granting leave to apply for review of a decision and granting leave to intervene in a review; extending the period within which a determination must be made; and allowing new information or material to be submitted;
  - c. the extent of participation in the merits review process by energy users, and identification of any barriers in the effective operation of the framework to participation by those groups;
  - d. the extent to which the Tribunal has remitted decisions to the regulator or made substitute decisions, and the nature of any decisions that have been remitted to the regulator;
  - e. the extent to which the regulator has exercised its powers under the merits review regime, including its ability to raise new matters before the Tribunal during merits review proceedings;
  - f. the cost implications of merits review proceedings for parties to the reviews;
  - g. features unique to the merits review regime which contribute to confidence in the regulatory regime to ensure the necessary investment occurs and alternatives for the provision of such features; and
  - h. identifying instances, if any, where merits review has favoured any particular parties and any evidence of 'gaming' by any parties.
2. An assessment and conclusions on the extent to which the policy intent set out in the MCE's policy decision *Review of Decision-Making in the Gas and Electricity Regulatory Frameworks* has been achieved, including the reasons for this finding.
3. A summary in tabulated form of the different appeal mechanisms used in other regulated sectors in Australia and overseas. This will include:

---

<sup>55</sup> Note that under Relevant Matters for Consideration below, the consultant is required to consider the paper, Gray, H., *Shaping utility regulation: Seminal decisions of the Australian Competition Tribunal and other review bodies*, 22 July 2011. This paper includes citations and headnotes for all cases appealed under the regime until July 2011 and is therefore a useful starting point.



- a. a description of the avenues for appeal for regulated utility businesses both in Australia and internationally (including those contained in the NEL and NGL);
- b. a description of the avenues for appeal for other regulated businesses, where deemed relevant;
- c. an analysis of the strengths and weaknesses of the different regimes; and
- d. an assessment of the applicability of the different regimes for the electricity and gas network businesses regulated under the NEL and NGL.

### *Stage Two*

In undertaking Stage Two of the Review the consultant is required to provide a Final Report, including:

- In light of findings from Stage One, including the materiality and treatment of interested parties, recommendations on the next steps for the SCER. This should include consideration of, but not be limited to:
  - a. amendments to the limited merits review regime;
  - b. amendments to other aspects of the NEL and NGL;
  - c. changes to the National Electricity Rules and National Gas Rules; and
  - d. the costs and benefits associated with the recommendations, in line with the NEO, NGO and revenue and pricing principles.

### **Relevant matters for consideration**

In addition to the factors outlined above, the consultant is to have regard to the following in conducting the review:

- MCE, *Decision: Review of Decision-Making in the Gas and Electricity Regulatory Frameworks*, May 2006 (**Attachment A**) – key content for consideration is -
  - the objectives of a review scheme as set out in section 2 of the paper; and
  - the matters that the MCE envisaged would be examined by a review as set out in Section 3 of the paper;
- MCE SCO, *Discussion paper: Review of Decision-Making in the Gas and Electricity Regulatory Frameworks*, October 2005;
- Administrative Review Council, *What Decisions Should be Subject to Merits Review?*, 1999;
- *Economic Regulation of Network Service Providers* Rule change proposal (available at [www.aemc.gov.au](http://www.aemc.gov.au))<sup>56</sup> and other related rule change proposals submitted to the AEMC; and

In addition, the consultant must take into account:

- information gathered through consultation;

---

<sup>56</sup> The AER has recently submitted a Rule change proposal to the AEMC that proposes significant changes to the manner in which the AER's regulatory determinations will be made. The outcome of the Rule change proposal could have an impact on the extent to which the merits review provisions are required and utilised in the future. The consultant is to have regard to the Rule change process throughout the Review, and consider its implications when making recommendations. The AEMC has indicated that it expects to make a final determination on the Rule change proposal by 15 October 2012.

- information from recently published reports which have considered this framework (for example the Garnaut Updates; Alviss Consulting on behalf of the Consumer Action Law Centre and Consumer Utilities Advocacy Centre, *Barriers to fair network prices: An analysis of consumer participation in the merits review of AER EDRP determinations*, August 2011; and Gray, H., *Shaping utility regulation: Seminal decisions of the Australian Competition Tribunal and other review bodies*, 22 July 2011); and
- any other relevant information

### **Consultation for the Review**

The consultant, or a party appointed after discussion with the consultant, must engage in targeted consultation in undertaking Stage One of the Review. The consultant must engage in open consultation in undertaking Stage Two of the Review. The SCER SCO considers that the consultant should engage as relevant with the following range of stakeholders for both Stage One and Stage Two of the Review:

- the SCER SCO or its nominated representatives;
- the jurisdictions;
- the Australian Energy Market Commission;
- the Australian Energy Regulator;
- the Australian Energy Market Operator;
- the Australian Competition Tribunal;
- the Administrative Appeals Tribunal;
- consumer groups, including small and large users; and
- network business groups.

### **Timeframe and deliverables**

The consultant is required to meet with the SCER SCO early in the Review process to discuss the scope of the Review and the requirements around deliverables. This meeting could be either face-to-face or via teleconference. The details of the meeting will be finalised on appointment of the consultant.

#### *Stage One*

The consultant, or a party appointed after discussion with the consultant, is required to provide:

- fortnightly telephone updates to the SCER SCO;
- an interim report to the SCER SCO by 30 April 2012; and
- a final version of the Stage One report by 30 June 2012.

#### *Stage Two*

The consultant is required to provide:

- an interim report to the SCER SCO by 31 August 2012; and
- a final version of the Stage Two report by 30 September 2012.

## **ANNEX 5: LIST OF SUBMISSIONS RECEIVED**

- Energy Networks Association (Received: 3 April 2012)
- Henry Ergas (Received 9 August 2012)

### *Consultation Paper One*

- APA Group (Received: 11 April 2012)
- Australian Pipeline Industry Association (Received: 20 April 2012)
- Consumer Action Law Centre (Received: 13 April 2012)
- Consumer Utilities Advocacy Centre (Received: 13 April 2012)
- Energy Networks Association (Received: 19 April 2012)
- Energy User Association of Australia (Received: 9 May 2012)
- Ergon Energy (Received: 18 April 2012)
- ETSA Utilities, CitiPower and Powercor Australia (Received: 17 April 2012)
- Financial Investors Group (Received: 13 April 2012)
- Jemena (Received: 13 April 2012)
- Major Energy Users (Received: 13 April 2012)
- Total Environment Centre (Received: 17 April 2012)
- The National Competition Council (Received: 18 April 2012)

### *Consultation Paper Two*

- The Australian Energy Regulator (Received: 7 June 2012)
- Australian Pipeline Industry Association (Received: 1 June 2012)
- Consumer Action Law Centre (Received: 31 May 2012)
- Consumer Utilities Advocacy Centre (Received: 15 May 2012)
- Victoria Department of Primary Industries (Received: 15 June 2012)
- Energy Networks Association (Received: 1 June 2012; 22 June 2012)
- Energy User Association of Australia (Received: 13 June 2012)
- Ergon Energy (Received: 1 June 2012)
- ETSA Utilities, CitiPower and Powercor Australia (Received: 1 June 2012)
- Financial Investors Group (Received: 6 June 2012)
- Grid Australia (Received: 1 June 2012)
- Mr Ray Finkelstein QC (Received: 12 June 2012)
- Independent Pricing and Regulatory Tribunal (IPART) (Received: 1 June 2012)
- Jemena (Received: 1 June 2012)
- Major Energy Users (Received: 30 May 2012)
- SP Ausnet (Received: 1 June 2012)
- Economic Regulation Authority of Western Australia (Received: 21 June 2012)
- Ausgrid (Received 29 June 2012)

*Discussion Paper Three*

- Australian Energy Regulator (Received: 28 August 2012)
- Australian Pipeline Industry Association (Received: 23 August 2012)
- Consumer Action Law Centre (Received: 29 August 2012)
- Consumer Utilities Advocacy Centre (Received: 27 August 2012))
- Department of Primary Industries (Received: 24 August 2012)
- Energy Networks Association (Received: 24 August 2012)
- Energy Users Association of Australia (Received: 3 September 2012)
- ETSA Utilities, CitiPower and Powercor (Received: 23 August 2012)
- Financial Investor's Group (Received: 24 August 2012)
- Mr Ray Finkelstein (Received: 3 September 2012)
- Independent Pricing and Regulatory Tribunal (Received: 15 August 2012)
- Jemena (Received: 27 August 2012)
- Major Energy Users (Received: 24 August 2012)
- Origin (Received: 24 August 2012)
- United Energy and Multinet Gas (Received: 31 August 2012)
- SP AusNet (Received: 24 August 2012)

## ANNEX 6: PUBLIC FORUM ATTENDEES

### A. 6.1 Organisations at the Public Forum, Wednesday 9 May 2012

- Australian Competition and Consumer Commission
- ActewAGL
- Australian Energy Market Commission
- Australian Energy Market Operator
- Australian Energy Regulator
- Australian Government Department of Resources, Energy and Tourism
- APA Group
- Australian Pipeline Industry Association
- Chris Harvey Consulting
- Ausgrid
- Australian Council of Social Services
- Carbon Markets
- CitiPower and Powercor
- Consumer Action Law Centre
- Consumer Utilities Advocacy Centre
- Dampier to Bunbury Pipeline
- DLA Piper
- Energy Networks Association
- Energex
- Energy Retailers Association of Australia
- Economic Regulation Authority of Western Australia
- Ergon Energy
- Ernst & Young
- Energy Supply Association of Australia
- Essential Energy
- Energy Users Association of Australia
- Gilbert + Tobin
- IPART
- Jemena
- Major Energy Users
- MinterEllison
- NERA
- NSW Department of Trade & Investment, Regional Infrastructure and Services
- Origin
- Powerlink Queensland
- Productivity Commission
- PriceWaterhouseCoopers
- Queensland University of Technology
- South Australian Department for Manufacturing, Innovation, Trade, Resources and Energy
- Synergies
- TransGrid
- United Energy and Multinet Gas
- UnitingCare Wesley Adelaide
- Victoria Department of Primary Industries

## **A. 6.2 Organisations at the Public Forum, Monday 31 July 2012**

- APA Group
- Ashurst Australia
- Ausgrid
- Australian Energy Market Commission (AEMC)
- Australian Energy Regulator (AER)
- DLA Piper
- Dampier to Bunbury Pipeline (DBP)
- Department of Manufacturing, Innovation, Trade, Resources and Energy (South Australia)
- Department of Primary Industries (Victoria)
- Department of Trade (New South Wales)
- Economic Regulatory Authority (ERA)
- Energy Networks Association (ENA)
- Energy Retailer's Association of Australia (ERAA)
- Energy Users Association of Australia
- ETSA Utilities
- Gilbert + Tobin Lawyers
- Independent Pricing and Regulatory Tribunal (IPART)
- Jemena
- Johnson, Winter & Slattery
- JP Morgan
- NERA Economic Consulting
- Origin
- Productivity Commission
- SP AusNet
- Transgrid

**ANNEX 7: ACTING SOLICITOR GENERAL'S OPINION NO. 22 OF 2012 DATED  
12 SEPTEMBER 2012**



SG No. 22 of 2012

**IN THE MATTER OF THE LIMITED MERITS REVIEW REGIMES IN THE  
NATIONAL ELECTRICITY LAW AND THE NATIONAL GAS LAW**

**OPINION**

**Introduction**

1. The Standing Council on Energy and Resources (**SCER**) has appointed an Expert Panel to review the effectiveness of the limited merits review (**LMR**) regimes established under the National Electricity Law (**NEL**) and the National Gas Law (**NGL**). In accordance with its Terms of Reference, the Expert Panel is to report in two stages, first giving an overview assessment of how the LMR regimes have operated and the extent to which certain policy objectives have been achieved, and secondly, recommending any changes, including amendments to the LMR regimes. The Expert Panel submitted its Stage One Report on 29 June 2012 and is due to submit its Stage Two Report by 30 September 2012. In its Stage One Report, the Expert Panel identified what it called a “major question” as to why the Australian Energy Regulator (**AER**) has “systematically declined



to use” statutory powers conferred by the LMR regimes enabling the AER to raise matters not raised by an applicant or intervener in a review, or to raise a possible outcome or effect of the decision under review being set aside or varied. It identified as a “related question” why the Australian Competition Tribunal (**Tribunal**), when “standing in the shoes of the AER”, has not itself sought to broaden the scope of applications for review before it. The Expert Panel expressed an “initial view” to the effect that the law does not prevent the AER or Tribunal from broadening the scope of a review in these ways. I am instructed by the Australian Government Solicitor to advise the Department of Resources, Energy and Tourism (which seeks my advice on behalf of SCER and the Expert Panel) as to the correctness of the Expert Panel’s “initial view”.

2. The precise questions I am asked and my answers to them are set out at the end of this Opinion. My short advice is that the relevant provisions of the NEL and NGL, properly construed, do not permit the scope of a review to be broadened. However, matters not raised by an applicant or intervener (as distinct from grounds for review) may be considered in limited circumstances and for limited purposes.

### **Statutory schemes**

3. The NEL is contained in a schedule to the *National Electricity (South Australia) Act 1996* (SA) and the NGL is contained in a schedule to the *National Gas (South Australia) Act 2008* (SA). The NEL and NGL (**Acts**) are applied as law by legislation in force in those States and Territories which participate in each scheme, and as Commonwealth law in the circumstances provided by the *Australian Energy Market Act 2004* (Cth).
4. Broadly similar frameworks for merits review exist under the NGL (as enacted) and the NEL (as inserted by s 46 of the *National Electricity (South Australia) (National Electricity Law – Miscellaneous Amendments) Amendment Act 2007* (SA)). They reflect the substance of a

decision of the Ministerial Council on Energy, the predecessor of SCER, made in May 2006 concerning the appropriate scheme for review of decision-making in the gas and electricity regulatory frameworks. Those merits review frameworks are contained within Division 3A of Part 6 of the NEL and Part 5 of Chapter 8 of the NGL.

5. The Acts permit an “affected or interested person or body” to apply to the Tribunal, with leave of the Tribunal, for a review of a “reviewable regulatory decision” (s 71B NEL; s 245 NGL). In each case, a “reviewable regulatory decision” is defined to include particular categories of decision, including those as prescribed by regulation (s 71A NEL; s 244 NGL). The Acts regulate the grant of leave required to apply for review, including by providing that the Tribunal must not grant leave unless there is “a serious issue to be heard and determined” as to “whether a ground for review ... exists” (s 71E NEL; s 248 NGL). It is a central feature of the merits review frameworks – giving rise to their description as “limited” merits review regimes – that an application for review may be made only on one or more specified grounds. The grounds encompass material error of fact, incorrect exercise of discretion, and unreasonableness in all the circumstances (s 71C NEL; s 246 NGL).
6. The Acts permit intervention in applications for review by certain persons without leave (s 71J NEL; s 253 NGL) and certain other persons with leave (ss 71K, 71L NEL; ss 254, 255 NGL), and permit interveners to raise any of the specified grounds, even if not raised by the applicant for review (s 71M NEL; s 256 NGL). The applicant, the original decision maker and an intervener are designated as “parties” to the review (s 71N NEL; s 257 NGL).
7. Section 71O of the NEL and s 258 of the NGL govern the “matters” that parties may and may not raise in a review. A party (other than an original decision maker) “may not raise any matter”, in the case of the NEL, that “was not raised in submissions to the

AER” (s 71O(2)) and, in the case of the NGL, that “was not raised in submissions in relation to the reviewable regulatory decision” (s 258(2)), “before the decision was made”. That is, applicants and interveners may raise only matters that were raised in submissions before the original decision maker. In each case, the second reading speeches to the Acts explain that this limitation was intended to “make the original decision making process meaningful” (Second Reading Speech for the *National Gas Law (South Australia) Act 2008*: South Australia, *Parliamentary Debates*, Legislative Council, 30 April 2008, 2546 (The Hon P. Holloway); Second Reading Speech for the *National Electricity (South Australia) (National Electricity Law – Miscellaneous Amendments) Amendment Act 2007 (SA)*: South Australia, *Parliamentary Debates*, House of Assembly, 27 September 2007, 967 (The Hon P.F. Conlon)).

8. The original decision maker, not inconsistently with this policy, is in a different position in relation to the “matters” it may raise on review. Section 71O(1) provides:

- (1) The AER, in a review under this Subdivision, may raise –
- (a) a matter not raised by the applicant or an intervener that relates to a ground for review, or a matter raised in support of a ground for review, raised by the applicant or an intervener;
  - (b) a possible outcome or effect on the reviewable regulatory decision being reviewed that the AER considers may occur as a consequence of the Tribunal making a determination setting aside or varying the reviewable regulatory decision.

Section 258(1) of the NGL is identical, save for it referring to “an original decision maker” instead of “the AER” so as to encompass the other original decision makers that are contemplated by the definition of “reviewable regulatory decision” in the NGL. Nothing turns on the difference for present purposes.

9. The Acts provide that the Tribunal must make a determination if it grants leave to an applicant for review (s 71P(1) NEL; s 259(1) NGL). The Tribunal may affirm, set aside or vary the reviewable regulatory decision, or remit the matter back to the original

decision maker to make the decision again in accordance with any direction or recommendation of the Tribunal (s 71P(2) NEL; s 259 NGL(2)). Section 71P(3) of the NEL and s 259(3) of the NGL each provide that “for the purposes of making a determination of the kind in subsection 2(a)” – that is, to affirm, set aside or vary the original decision – the Tribunal “may perform all the functions and exercise all the powers of” the original decision maker. The Acts also limit and prescribe the materials that the Tribunal can consider in making its determination (s 71R NEL; s 261 NGL).

## **Analysis**

### *Limited grounds for review*

10. “Review”, in the administrative law context, “has no settled pre-determined meaning” but “takes its meaning from the context in which it appears”: *Brandy v Human Rights and Equal Opportunity Commission* (1995) 183 CLR 245 at 261 per Mason CJ, Brennan and Toohey JJ. The powers of the Tribunal to review regulatory decisions within the LMR regimes derive wholly from the Acts, and the scope and nature of the review that it must conduct can be ascertained only by close attention to the statutory framework.
11. As explained above, an application for review requires leave of the Tribunal, and the Tribunal must not grant leave if there is not a serious issue “as to whether a ground for review ... exists”. The available grounds for review are only those identified in the Acts and it is for an applicant (or intervener) to “specify the grounds for review being relied on” (s 71B(2)(b) NEL; s 245(2)(b) NGL) and to establish the grounds for review that it raises (ss 71C(2), 71M(2) NEL; ss 246(2), 256(2) NGL).
12. Since the grounds for review are those specified by an applicant or intervener, there is no scope for the addition of other grounds for review. Section 71O(1) of the NEL and the

equivalent s 258 of the NGL do not provide otherwise. Paragraph (a) of each section permits the original decision maker to raise a “matter” not otherwise raised. However, the matter must “relate[] to” a ground for review “raised by” the applicant or intervener, or a matter in support of a ground for review “raised by” the applicant or intervener. Paragraph (b) permits the original decision maker to raise “a possible outcome or effect” of the Tribunal setting aside or varying the original decision, but similarly does not broaden the basis (that is, the grounds) on which the Tribunal might set aside or vary the decision or the decisions under review. Both paragraphs (a) and (b) relate to the role of the original decision maker “in a review under this Subdivision” (NEL) or “in the review” (NGL) – that is to say, they confer powers on the original decision maker in a review, the scope of which is necessarily already defined by the grounds for review properly specified by an applicant or intervener.

13. The scope of a review before the Tribunal cannot, therefore, be broadened by the AER or the Tribunal itself to encompass additional grounds of review. In this regard, the following observations of Neaves J in *Inglis v Bateson* (1990) 99 ALR 149 at 164 are apposite (albeit directed to a different statutory regime):

I am unable to accept the submission ... that s 76Z(1) [of the *Public Service Act 1922* (Cth)], in so far as it identifies the ground of appeal, is to be characterised as a provision concerning the manner and form of the notice of appeal with no operative effect upon the role of the appeal tribunal. In my opinion, the legislature has, by delineating the ground of appeal in that way, also marked out the limit of the appeal tribunal’s function. The appeal is not at large. It is more restricted than that – it is confined to the stated ground.

These observations were cited with approval by Wilcox J in *Preston v Carmody* (1993) 44 FCR 1 at 16-17. To similar effect is the unreported decision of von Doussa J in *Parker v Australian National Railways Commission* [1990] FCA 396.

14. The nature of review under the Acts is confined accordingly. Unlike the Administrative Appeals Tribunal (AAT), which is established by the *Administrative Appeals Tribunal Act 1975* (Cth) (AAT Act), the Tribunal is not empowered to make the “correct or

preferable” decision where a range of decisions might properly be open: cf *Drake v Minister for Immigration and Ethnic Affairs (No 1)* (1979) 2 ALD 60 at 68 per Bowen CJ and Deane J. In contrast to the NEL and NGL, the AAT Act does not prescribe particular grounds for review. The AAT does not therefore need to find “something wrong” with the decision under review: Dennis Pearce, *Administrative Appeals Tribunal* (2<sup>nd</sup> ed, 2007) at 178. Rather, the AAT’s duty is to satisfy itself whether the decision under review is objectively “the right one to be made”: *Drake v Minister for Immigration and Ethnic Affairs (No 1)* (1979) 2 ALD 60 at 77 per Smithers J. The Tribunal, under the LMR regimes, is empowered to determine whether the original decision maker committed an error of the kind reflected in a ground for review properly raised in the application for review: *Application by Actem-AGL Distribution* [2010] ATPR 42-324 at [30]-[35]. Only if the Tribunal determines that the original decision maker committed an error of the specified kind, may it then set aside or vary the decision, or remit the matter to the original decision maker (s 71P NEL; s 259 NGL).

#### *Powers of Tribunal on review*

15. The Expert Panel has described the Tribunal as “standing in the shoes of” the original decision maker when making its determination, but this metaphor is apt to mislead and cannot supplant the statutory language. It is only “for the purposes of making a determination” to affirm, set aside or vary the original reviewable regulatory decision that the Tribunal “may perform all the functions and exercise all the powers of” the original decision maker (s 71P(3) NEL; s 259(3) NGL). These provisions share an affinity with the powers of the AAT under s 43(1) of the AAT Act, which a Full Court of the Federal Court has described as “powers ‘[f]or the purpose of reviewing’ the reviewable decision, not powers that may be exercised at large”: *Lees v Comcare* (1999) 56 ALD 84 at 93 per Wilcox, Branson and Tamberlin JJ. The consequence of this purposive limitation upon the capacity of the Tribunal to exercise the powers of the original decision maker is that

s 71P(3) of the NEL and s 259(3) of the NGL do not broaden the scope of a review. The Tribunal's capacity to exercise those powers is confined to the determination of the review as delimited by the grounds for review advanced by the applicant or intervener.

16. That said, it is important to recognise that the Tribunal is to review "a reviewable regulatory decision", as that phrase is defined in each of the NEL and NGL. A "reviewable regulatory decision" will be made up of several constituent or component decisions relating to individual parameters that are relevant to an overall determination (see, for example, rr 6.3, 6.12 National Electricity Rules). In a review before the Tribunal, it is the "reviewable regulatory decision" itself, and not simply a particular constituent or component decision said to be affected by error, that is the subject of the review and that is therefore liable to be affirmed, set aside or varied, or remitted.
  
17. The significance of this circumstance is that if a ground of review is made out, and the Tribunal is considering whether to affirm, set aside or vary the decision (s 71P(2)(a) NEL; s 259(2)(a) NGL), or remit the decision (s 71P(2)(b) NEL; s 259(2)(b) NGL), the Tribunal should have regard to the reviewable regulatory decision as a whole, including the inter-relationship, if any, between the erroneous aspect of the decision and other constituent parts of the decision. This is the very process intended to be facilitated by s 71O(1)(b) of the NEL and s 258(1)(b) of the NGL. And in considering the option of remittal, the Tribunal must have regard to the nature and relative complexities of the overall regulatory decision and the subject-matter of the review (s 71P(4) NEL; s 259(4) NGL), which reinforces the fact that, in exercising its dispositive powers, the Tribunal is expected to make an assessment of how the error discerned by it fits into, and impacts upon, the overall regulatory decision. It may be added that although s 71P(4) of the NEL and s 259(4) of the NGL refer explicitly only to consideration of *remittal*, that option is an alternative to all of the other dispositive powers given to the Tribunal (s 71P(2) NEL; s 259(2) NGL). Accordingly, the references to "in deciding whether to

remit a matter” in s 71P(4) of the NEL and s 259(4) of the NGL must be understood as directed to the alternatives referred to in s 71P(2) of the NEL and s 259(2) of the NGL respectively. Thus, for the purposes of performing its review role with respect to a ground of review that has been made out, the Tribunal could: (i) simply correct an error in the particular aspect of the decision, and leave all other aspects of the decision in place; (ii) correct the particular error in question and, as a consequence of so doing, vary other inter-dependent or inter-related aspects of the decision; or (iii) having regard to the nature and relative complexities of the overall decision and the subject-matter of its review, remit the matter back to the original decision maker to make the decision again, in accordance with any direction or recommendation of the Tribunal.

18. It is necessary to emphasise, however, that the power to make consequential corrections in the course of deciding whether to affirm, set aside or vary, or remit a “reviewable regulatory decision” is not so wide as to permit what one might call “opportunistic” or “free-standing” merits review of aspects of the decision which do not genuinely relate to an error raised in a ground of challenge. It would be wrong to think that after finding error in a particular aspect of the original decision, the Tribunal could set about to correct other unrelated errors on the basis of its own view that so doing would improve the overall merits of the reviewable regulatory decision. Similarly, it would be wrong to think that after finding error in a particular aspect of the original decision, the Tribunal could affirm the decision on the basis of its own view of the overall merits of the reviewable regulatory decision, notwithstanding the established error. To do so would be to allow the Tribunal to substitute its own assessment of the overall merits, and therefore to expand the review beyond the limitations imposed by the legislation.
19. Where the line is to be drawn in any particular context may well be a question of fact and degree.



## Questions and answers

20. The questions that I have been asked make reference to the Expert Panel's initial views expressed in the following terms:

- (a) Once grounds of appeal have been established, the law does not prevent the consideration of other aspects of an AER price control determination.
- (b) The AER and the Tribunal (when "standing in the shoes of the AER") are actually required to take account of other aspects of an AER decision when those other aspects are relevant to considering how the determination of prices or revenues might affect the long term interests of consumers.

21. It follows from the foregoing that my answers to the questions asked are as follows:

- (1) Are either or both of the views in paragraphs [20(a) and (b)] above mistaken interpretations of the law?

**Answer:** As to paragraph (a), the law does not prevent the Tribunal from considering other aspects of an AER price control determination that may be raised by the AER under s 71O(1) of the NEL or s 258 of the NGL, but allows consideration of such matters only for the purpose of conducting the review that is already before it, and not for the purpose of broadening the scope of the review. That is, a reviewable regulatory decision may be affirmed, set aside, varied or remitted back to the original decision maker only on the particular grounds advanced by the applicant and the intervener and those grounds must properly be available under the Acts. As to paragraph (b), the Tribunal is empowered to exercise the powers of the original decision maker only for the purpose of conducting the review that is properly before it.

- (2) If so, what exactly is it in the law that causes the Panel's initial views to be wrong?

**Answer:** This question is addressed in the response to Question One.

- (3) If paragraphs [20(a) and (b)] are not mistaken interpretations, is it nevertheless the case that there is significant ambiguity in the law as currently drafted, such as could reasonably lead to the alternative view that the law effectively prevents the AER and the Tribunal from broadening the range of issues considered during appeals?

**Answer:** Does not arise.

- (4) In that case, or if the views in paragraphs [20(a) and (b)] are mistaken, would the ambiguity be resolved, or the views in paragraph [20(a) and (b)] be implemented, by replacing the word "may" by the word "must" in subsection (1) of s 71O of the NEL and s 258 of the NGL?

**Answer:** No, because the scope of the review is delimited not by the absence of obligation on the AER to raise other matters, but by the provisions that establish the nature of the review, the parties to the review and the permissible grounds for review. Casting a duty in those terms may, in any event, give rise to uncertainty not considered for the purpose of this Opinion.

- (5) If not, are there other possible approaches which could implement the views in paragraphs [20(a) and (b)]?

**Answer:** The LMR regimes could be redrafted to establish a different merits review regime that, for example, does not specify or otherwise limit the grounds for review.

22. I advise accordingly.

Dated: 12 September 2012

A handwritten signature in black ink, appearing to read 'Tom Howe', with a stylized, looping initial 'T'.

**TOM HOWE**

Acting Solicitor-General

## GLOSSARY / ACRONYMS

AAT	Administrative Appeals Tribunal
ACCC	Australian Competition and Consumer Commission
ACT	Australian Competition Tribunal
AEAA	Australian Energy Appeals Authority
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
ARC	Administrative Review Council
Capex	Capital Expenditure
ENA	Energy Networks Association
ERA	Economic Regulation Authority of Western Australia
LMR	Limited Merits Review
MCE	Ministerial Council on Energy
NCC	National Competition Council
NEL	National Electricity Law
NEO	National Electricity Objective
NER	National Electricity Rules
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
NSPs	Network Service Providers
Opex	Operating Expenditure
RIS	regulatory impact statement
SCER	Standing Council on Energy and Resources
SCO	Senior Committee of Officials
<i>Stage One</i>	An overview assessment of how the LMR regime has operated to date in both the electricity and gas sectors, and of the extent to which policy outcomes anticipated in the MCE Decision Paper have been achieved. The Panel was required to submit an interim Stage One report to SCER SCO by

30 April 2012, with the final Stage One Report to be completed by 30 June 2012

*Stage Two* To provide advice to the SCER about whether changes to the avenues for appeal available for network businesses are required to deliver an appropriate balance between the commercial needs of the businesses and efficient outcomes for consumers, consistent with the National Electricity Objective (NEO) and National Gas Objective (NGO). The Panel was required to submit an interim Stage Two report to SCER SCO by 31 August 2012, with the final Stage Two Report to be completed by 30 September 2012.

the Panel an expert panel engaged to undertake the review of the limited merits review regime consisting of consists of Professor George Yarrow (Chair), Dr John Tamblyn and the Hon. Michael Egan