Standing Council on Energy and Resources
Senior Committee of Officials

Regulation Impact Statement

Limited Merits Review of Decision-Making in the Electricity and Gas Regulatory Frameworks

Consultation Paper

14 December 2012

Disclaimer

This Regulation Impact Statement (RIS) is for consultation only and should not be read as a settled or final view of the Senior Committee of Officials, participating jurisdictions, or the Council of Australian Governments (COAG) Standing Council on Energy and Resources (SCER), regarding the framework for review of regulatory decision making in the national electricity and gas frameworks. The RIS has been prepared solely to test the findings and recommendations reached by the Expert Panel in its *Review of the Limited Merits Review Regime* in a format consistent with the requirements of COAG guidelines for national standard setting and regulatory action by Ministerial Councils and Standard-Setting Bodies, to assist the determination of the appropriate course of action. In addition to views received on this document, stakeholder consultation received as part of the Expert Panel's review will be used to inform the policy decision on the preferred approach and will be used in the Impact Analysis for the final decision RIS.

Interpretation Note

This RIS addresses proposed changes to the Limited Merits Review Regime that applies to regulated electricity transmission and distribution network service providers and covered gas pipelines and distribution networks under the national energy laws. For ease, references to regulated network service providers, network businesses and the like should be read as also referring to service providers for covered gas pipelines and distribution networks unless otherwise specified.

For the purposes of this document the following interpretations should be used:

- "administrative review" is the process of assessing an initial decision on whether it is the correct or preferable decision, as set out in the Australian Administrative Law Policy Guide;
- "administrative process" entails the reviewing body standing in the shoes of the regulator to establish the merits of the original decision or alternatives as presented by the appellants. Administrative processes do not require that the participants have legal representation for effective engagement;
- "judicial nature" relates to adversarial and legally focused processes;
- "decision element" relates to the underlying building block elements for the regulatory determination;
- "overall decision" is the regulatory determination itself (i.e. the network businesses' approved revenue);
- "investigative process" entails actively seeking information that is critical to the matter being reviewed in the context of the overall decision, but not consideration of areas with no link to that decision; and
- "information not being unreasonably withheld" entails information that could be reasonably be expected to be available in time for the primary decision maker to consider in its decision-making process.

Executive Summary

The key objective of the national regulatory frameworks governing electricity and gas in Australia is to promote the long term interests of energy consumers. This is delivered through efficient investment in (that is, ensuring required investment represents the least cost over the long term for consumers) and use of energy infrastructure. An important part of the framework is to allow parties affected by decisions of the relevant regulator and other decision makers under the national energy laws appropriate recourse to have the merits of these decisions reviewed.

In developing the limited merits review framework in 2006 the Ministerial Council for Energy (MCE) agreed that the limited merits review regime should:

- maximise accountability;
- maximise regulatory certainty;
- maximise the conditions for the decision-maker to make a correct initial decision;
- achieve the best decisions possible;
- ensure that all stakeholders' interests are taken into account, including those of service and network providers, and consumers;
- minimise the risk of "gaming"; and
- minimise time delays and cost.

The limited merits review regime was introduced under the National Electricity Law (NEL) on 1 January 2008 and under the National Gas Law (NGL) on 1 July 2008, with the Australian Competition Tribunal[1] (the Tribunal) the nominated body to conduct the reviews. At this time, the MCE included a requirement in the NEL and NGL for a review of the effectiveness of the regime within the first seven years of the commencement of the relevant merits review provisions.

Growing debate on the effectiveness of the limited merits review regime led to the MCE's successor, the Standing Council on Energy and Resources (SCER) deciding to bring forward this review. On 22 March 2012, SCER announced that an independent expert panel (the Panel) of Professor George Yarrow as chair, Dr John Tamblyn and the Hon. Michael Egan was established to undertake this review. The Panel's task was to provide advice to the SCER on effectiveness of the limited merits review regime in meeting the original policy intention and any need for changes to the limited merits review regime. On 9 October 2012, the Panel's final report was published.

The Panel's report found that the original policy intention remained sound and relevant, but that, in its operation, the limited merits review regime has not delivered on the National Energy Objective (NEO), the National Gas Objective (NGO) or the original intentions agreed by the MCE. In particular the Panel found that not all stakeholders' interests were adequately taken into account, specifically the ultimate impact of the decisions on consumers, the Tribunal did not pay due consideration to the NEO and NGO in making its rulings, and the regime has been costlier to operate and cases have taken longer than anticipated at the outset.

The Panel also found that the Tribunal has used an overly legalistic approach, meaning the scope of reviews of regulatory decisions is unduly narrow and not consistent with the original policy intention; where reviews were only intended to be used rarely and only to

1 An administrative review body established under the *Competition and Consumer Act 2010* (Commonwealth)

address issues with a material consequence on the operation of the network business. In addition, the Panel considered this approach has led to consumer and user groups being disengaged from participating in the appeals process due to the high risks and costs, as well as the hostile environment.

The Panel noted there was the potential for some ambiguity around the intention of the limited merits review regime and recommended that SCER provide a clearer articulation of the policy intention of merits review. SCER's Senior Committee of Officials (SCO), consistent with the MCE's original policy intention, confirms and clarifies that the limited merits review regime should deliver the principles agreed by Ministers in 2006.

SCER's SCO considers that the Panel has provided evidence of regulatory failure, specifically in the areas of delivering the policy intention, the narrow focus of the review, accessibility of the regime, and timeliness for decision making. The purpose of this Regulation Impact Statement (RIS) is to test options and further analyse the Panel's proposals for changes to the limited merits review regime in light of the policy principles.

In considering improvements to the functioning of the limited merits review regime, SCO considers it useful to examine the Panel's proposals in terms of presenting three main options. This is for the purpose of facilitating feedback, rather than suggesting that one of the options must be accepted or rejected in entirety. It is recognised that some elements of different options may have appeal to stakeholders. Detail on these options is provided in Table 1.

Option 1 is the preservation of the **status quo** (noting the background context includes recent rule changes and reforms) and retains the current framework that is set out in the NEL and NGL with the Tribunal as the review body for all reviewable decisions.

Option 2 is a substantial refinement to the current regime and involves amendments to the limited merits review framework as proposed by the Panel, but **retains the Tribuna**l as the review body for all reviewable decisions. The major change is allowing only **a single ground of appeal**; that is, a materially preferable decision exists. The Tribunal would be required to operate in a purely administrative and not adversarial or judicial manner as currently occurs.

Option 3 is a full implementation of the Panel's recommendations. Option 3 entails the framework changes as per Option 2, but with the establishment of a **new limited merits review body** (the Review Body). A key difference in Option 3 is that the Review Body would adopt an investigative approach to review of the relevant decisions, with the views of interested parties including consumers being routinely sought throughout the process.

The Panel recommended that the Review Body should be an independent panel, but attached to an existing administrative organisation and proposed the Australian Energy Market Commission (AEMC)[2] as the host agency. The overhead costs of the review panel would be shared among network service providers in proportion to their annual revenues.

Subject to further consultation, SCO notes this option assumes a number of specific details about how the Review Body would function in practice, which are to be tested by this consultation process and compared with other review bodies. It is therefore recognised that if Option 3 is ultimately preferred it might be a variant of the Panel's specific proposal.

Both options 2 and 3 will focus on whether the decision was justified in terms of the NEO or NGO, and on whether there exists a materially preferable decision. This shift in focus is intended to reduce appeal activity and generate better decisions by both the primary decision maker and the Review Body.

2 A national energy market institution responsible for Rule making and market development.

The proposed changes to the limited merits review regime involved in Option 2 will go partway to addressing the issues identified by the Panel, but the Panel argued that the key to unlocking the benefits of change involves shifting the focus of the Tribunal away from operating in a judicial manner and this requires a cultural change. Under Option 3, a dedicated review body will be established to operate in an administrative manner, which is more suitable for reviews of decisions that involve the exercise of significant discretionary powers. Under this option, the review is intended to be an exercise in seeking to discover whether there exists a materially preferable decision, rather than a contest between interest groups.

There are risks associated with all three options. With Option 2, the Tribunal would be required to function administratively rather than a legalistic or adversarial approach. History suggests that tribunals in Australia have tended to adopt judicial operating approaches. With Option 3, the new Review Body will be untested, with new grounds of appeal and practices, meaning there may be uncertainty in the early days of its operations. Depending on the "host agency" selected, issues of potential conflict of interest may need to be addressed.

To arrive at a fully informed decision, this RIS contains a number of questions for stakeholder consideration.

In making submissions, stakeholders should focus on providing evidence of the potential impacts of the options under consideration. To inform development of a final policy position as part of developing the decision RIS, stakeholders are also requested to provide details about the advantages and disadvantages, costs and benefits and risks associated with each option, preferably supported by quantitative evidence. Any alternative proposals or variation to the options herein presented by stakeholders should be supported by sufficient evidence of the comparative benefits.

In addition, noting the complex interactions between the electricity and gas objectives, the pricing and revenue principles and the objective for the limited merits review regime, SCO seeks input on the short and long term implications of each option for different stakeholders. Consequently, SCO requests that submissions provide information on short and long term outcomes.

For the purposes of this consultation RIS, all three options are assessed on the basis that the following related changes to the energy markets regulatory framework are in place:

- the Australian Energy Market Commission's 29 November 2012 final determination for the Economic Regulation of Network Service Providers Rule Change;
- foreshadowed in the 23 November 2012 SCER meeting:
  - measures to strengthen the regulator, in the areas of resourcing, performance and accountabilities; and
  - the establishment of a consumer panel to prosecute consumers' views in the regulatory process for network pricing decisions, including subsequent appeals.

Options[3]

Table 1: Summary of options

	Option 1 **Status Quo** **(Division 3A of Part 6 of the NEL and Part 5 of Chapter 8 of the NGL)**	**Option 2** **Amendments to the merits review framework while retaining the Australian Competition Tribunal as the review body**	**Option 3** **Amendments to the merits review framework and a new merits review body**
Grounds for review	Four grounds of review based on regulatory errors of fact or discretion, unreasonableness and a demonstration there is a serious issue to be heard. s71C of NEL and s246 of NGL	Single ground of appeal: there are reasons for believing a materially preferable decision may exist and the primary regulator's decision has not promoted efficiency in the long term interests of consumers.	Single ground of appeal: there are reasons for believing a materially preferable decision may exist and the primary regulator's decision has not promoted efficiency in the long term interests of consumers.
Who may apply for a review of a decision	An affected or interested person or body, with the leave of the Tribunal, may apply to the Tribunal for a review. Affected or interested persons or bodies include the regulated network service provider; and a network service provider, user, prospective user or end user whose commercial interests are materially affected by the decision; or a user or consumer association. s71B of NEL and s245 of NGL	Applications for review will be open to regulated network businesses, energy ministers, consumer/user representatives, and other parties with a sufficiently material interest in the decision. The Tribunal will assess whether the applicant has a sufficiently material interest according to high level guiding principles in the national energy laws.	Applications for review will be open to regulated network businesses, energy ministers, consumer/user representatives, and other parties with a sufficiently material interest in the decision. The Review Body will assess whether the applicant has a sufficiently material interest.
Materiality threshold	The lesser of $5,000,000 or 2% of the average annual regulated revenue of the regulated	Threshold is set out in Option 1. Appeals only allowed if, on the basis of relevant	Review body to determine the materiality threshold as this could vary significantly

[3] All options are based on the introduction of the new rules around economic regulation published by the Australian Energy Market Commission on 29 November 2013, together with proposed measures for the strengthening of the regulator and establishment of a consumer panel to prosecute consumers' views in the regulatory process for pricing decisions, including subsequent appeals as foreshadowed at the 23 November 2012 SCER meeting.

	Option 1	Option 2	Option 3
	network service provider. s71F(2) of NEL and s249(2) of NGL	evidence and substantiated reasoning, the Tribunal is convinced that there exists a materially preferable decision.	between appeals and provide this information to stakeholders through publishing a guideline or guidance note. Appeals only allowed if, on the basis of relevant evidence and substantiated reasoning, the Review Body is convinced that there exists a materially preferable decision.
Who may intervene in a review and parties to the review	Regulated network service provider or a Minister of a participating jurisdiction may intervene in a review without leave of the Tribunal, and the Tribunal may grant leave to intervene to a user, consumer or a person or body who is a reviewable regulatory process participant. s71J of NEL and s257 of NGL	Regulated network businesses, energy ministers, consumer / user representatives and other parties with a sufficiently material interest in the decision can all intervene without leave of the Tribunal. The sufficient material interest of other parties needs to be established by the Tribunal before they can be classified as an intervener. Views of all interested parties routinely invited by the Tribunal at the review stage, where this does not entail admission of new material.	Regulated network businesses, energy ministers, consumer / user representatives and other parties with a sufficiently material interest in the decision can all intervene without leave of the Review Body. The sufficient material interest of other parties needs to be established by the Review Body before they can be classified as an intervener. Views of interested parties routinely invited by the Review Body throughout the process. New material may only be admitted where it was not unreasonably withheld from the primary decision maker at the time of the decision.
Consumer engagement	Consumer / user representatives may only be granted leave to intervene by the Tribunal if they raise a matter that will not be raised by the regulator or they can demonstrate that their specific interests are affected by the decision that is subject to review. s71L of NEL and s255 of NGL	Consumer / user representatives with a sufficiently material interest in the decision may intervene. Consumer views routinely invited by the Tribunal at the review stage, where this does not entail admission of new material. No requirement for legal representation.	Consumer / user representatives with a sufficiently material interest in the decision may intervene. Consumer views routinely invited by the Review Body throughout the process. No requirement for legal representation. Restrictions on new material as above.

	Option 1	Option 2	Option 3
Review body approach	ADMINISTRATIVE – quasi-judicial Presided by a judge of the Federal Court. Reviews are conducted by an administrative body using a more adversarial / quasi-judicial approach: legal proceedings are utilised during the review, legal representation is expected but not required, and court like processes with high barriers to participation.	ADMINISTRATIVE – administrative Presided by a judge of the Federal Court. Reviews are conducted with an administrative and less adversarial approach: legal representation is not expected, and explicit reference made in the national energy laws allowing the Tribunal to use concurrent evidence. [4] The Tribunal will assess whether a materially preferable overall decision is available with specific reference to the NEO and NGO i.e. the long-term interests of consumers. (That is, specific issues or errors raised by the appellant may be considered in the context of the impact on the overall decision).	ADMINISTRATIVE – investigative Presided by a Chair. Reviews are conducted with an administrative and more investigative and inquisitorial approach, more akin to an audit process: legal representation is not expected and evidence can be sought from any party to the review. The Review Body will assess whether a materially preferable overall decision is available with specific reference to the NEO and NGO i.e. the long-term interests of consumers. (That is, specific issues or errors raised by the appellant may be considered in the context of the impact on the overall decision). The main focus of the investigative approach is expected to be on related matters that formed the original decision, noting that the Review Body will be sufficiently resourced to conduct reviews that potentially reach any aspect of the relevant regulatory decision.
Trigger for review	A component of the reviewable decision.	A component of the reviewable decision, where it can be demonstrated as resulting in a materially preferable decision.	A component of the reviewable decision, where it can be demonstrated as resulting in a materially preferable decision.
Matters that parties may and may not	AER may raise a new matter and/or a possible outcome or effect that may occur as	Matters that can be raised by participants during the review must be demonstrated to be	All matters can be raised by participants, and can potentially relate to any aspect of the

[4] For example, see the Guidelines for the Use of Concurrent Evidence in the Administrative Appeals Tribunal http://www.aat.gov.au/LawAndPractice/PracticeDirectionsAndGuides/Guidelines/ConcurrentEvidence.htm

	Option 1	Option 2	Option 3
raise in a review	a consequence of the Tribunal varying or setting aside a decision. An intervener may raise new grounds not raised by the applicant (s71M). A party (other than AER) may not raise a matter not raised in submissions to the AER. s71O of NEL and s261 of NGL	pertinent or linked to the issue the appellant raised as underpinning the ground for review,	decision to assist the Review Body in determining whether a preferable overall decision exists.
Matters that the reviewing body can and cannot consider	EXISTING MATERIAL The Tribunal must not consider any matter other than *review related matter*, noting the Tribunal may allow new information or material to be submitted if the new information or material would assist it on any aspect of the decision to be made; and was not unreasonably withheld from the AER when it was making the reviewable regulatory decision. s71R of NEL and s261 of NGL	EXISTING MATERIAL The Tribunal would only have access to the information that was before the decision maker at the time of its decision until the ground for review had been established. Following the establishment of the ground for review, the Tribunal could seek additional information from the interveners, subject to that information not being unreasonably withheld from the primary decision maker at the time of the decision and where it can be shown that this has a direct bearing on the issue before the Tribunal.	INVESTIGATIVE The Review Body would only have access to the information that was before the decision maker at the time of its decision until the ground for review had been established. Following the establishment of the ground for review, the Review Body could consider any component of the original decision and will use an open accessible process and investigative approach to determine whether a preferable decision exists. The Review Body can supplement the record with evidence from its own investigations and may invite interested parties to give views on the matter. In obtaining information from network service providers, the Review Body must have regard to whether that information was unreasonably withheld from the primary decision maker at the time of the initial decision.

	Option 1	Option 2	Option 3
Timeframe for application	An applicant has 15 business days to bring an application for review. s71D of NEL and s247 of NGL	As with Option 1.	As with Option 1.
Timeframe for review	Three months (after granting leave) but may be extended. s71Q of NEL and s260 of NGL	Six months in total: two months to determine if there is a ground for review and four months for the review process (with the possibility of extension in certain circumstances if warranted).	Six months in total: two months to determine if there is a ground for review and four months for the review process (with the possibility of extension in certain circumstances if warranted).
Decisions subject to merits review	• AER pricing and revenue determinations for transmission and distribution in electricity (including application of regulatory test); • Ministerial decisions in relation to coverage of gas pipelines (including binding no-coverage determinations); • Decisions by the NCC on the form of regulation to apply in gas; • AER decisions to draft and approve (or revise) gas access arrangements; • AER ring fencing decisions, including non-approval or voiding of associate contracts, in gas; and • AER decisions not to exempt entities from ring fencing guidelines or impose additional ring fencing requirements, in electricity.	As for Option 1.	Similar to Option 1 **except** for Ministerial and NCC decisions which, due to the changes to the Review Body, the Panel recommended as being better served under the review arrangements that exist for Ministerial declaration decisions more generally under the Part IIIA access framework of the *Competition and Consumer Act 2010.*

	Option 1	Option 2	Option 3
	s71A of NEL and s244 of NGL		
Allocation of costs in a review	Overhead costs of the Tribunal covered by Federal Court; funded by the Australian Government. The Tribunal may order a party to pay all or a specified part of the costs of another party to the review. s71X of NEL and s268 of NGL	As with Option 1.	Overhead costs of Review Body shared among network service providers in proportion to their annual revenues, of which 50 per cent should be allowed as a recoverable cost in revenue determinations unless otherwise determined by the Review Body. Direct costs of the Review Body in individual cases borne in the first instance by network service providers, 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.
Review panel size	Three members - presided by a judge of the Federal Court as the President and two further members.	As with Option 1.	Five member panel for each individual review. Chair and pool of panel members appointed according to established criteria. Individual panel members selected by Chair to meet needs of each individual review.
Process for determination	The Tribunal can affirm, set aside or vary the reviewable regulatory decision or remit the matter back to the AER to make the decision again, in accordance with any direction or recommendation of the Tribunal. s71P of NEL and s259 of NGL	As with Option 1.	Similar to Option 1 **except** the Review Body replaces the Tribunal.
Limitations	The review is limited by the grounds of appeal, the time required for the Tribunal to	The review is limited by the material the Tribunal can consider before a ground for	The review is limited by the material the Review Body can consider before a ground for

	Option 1	Option 2	Option 3
	complete its processes and the appeal relating to matters above the threshold.	review has been established; adopting the record of decision of the primary decision makers' process as the starting point; and the time limitations for applications and for the Tribunal to complete its processes. The scale of review activity will also be limited by the materiality threshold set out in the NEL and NGL.	review has been established; adopting the record of decision of the primary decision makers' process as the starting point; and the time limitations for applications and for the Review Body to complete its processes. The scale of review activity will also be limited by materiality thresholds to be determined by the Review Body.
Process for appeal of Review Body decision	Judicial review in the Federal Court of Australia.	As with Option 1.	As with Option 1.
Support body – administrative	Administrative support provided by the Federal Court of Australia by staff appointed as Commonwealth Public Servants.	As with Option 1.	Associated body (AEMC) would supply resources to be temporarily seconded to assist with the review, arrange contracting with consultants as necessary and provide ongoing secretariat, administrative system and back office support services.
Support body – technical	The Tribunal can contract consultants as necessary.	As with Option 1.	In the first instance, the Review Body itself would have a broad range of technical expertise relevant to the review. The associated body (e.g. the AEMC) would generally provide further technical assistance. Consultants could be contracted by the associated body as necessary to provide additional technical services to the Review Body.

Questions for stakeholders

General

1. Do stakeholders agree access to merits review should be maintained? Stakeholders may wish to offer comment on their reasons for wishing to pursue or not pursue this alternative.
2. Do stakeholders consider that a consistent approach to limited merits reviews of electricity and gas regulatory decisions remains appropriate? Please provide your reasoning for this position.

Option 1 – Status Quo

3. Are there any minor amendments to the NEL or NGL that could address the problems identified by the Panel?
4. To what extent do recent reforms, most notably recent network regulation rule changes, address the concerns identified by the Panel?

Option 2 – Amendments to the framework as proposed by the Panel, but retaining the Tribunal as the review body

5. What impact would the move to a single "materially preferable decision" criterion have on the outcomes of the limited merits review regime? Specifically, to what extent would such a criterion be compatible with retaining the Tribunal as the Review Body and what limitations might apply to the Tribunal in administering such a criterion?
6. Are there any barriers to the Tribunal effectively performing its role in a purely administrative manner? What impacts would a move to a more administrative, less judicial approach have on the review process including the extent to which it would reduce or remove the need for participants to engage legal counsel?
7. What, if any, restriction should be applied to the information the Tribunal can consider after the ground for review has been established? Are there any benefits associated with allowing the Tribunal to consider information that the regulator could not have reasonably considered in its initial decision making process.

Option 3 – Amendments to the framework as proposed by the Panel and establishing a new limited merits review body

8. Are there specific benefits and risks associated with the Panel's model for the Review Body? Do stakeholders have any views on how the model could be modified to address these risks? This might include, but not limited to, the restrictions around information or process. How might those modifications affect the effectiveness of the investigative process?
9. What level of prescription around the establishment and operation of the Review Body do stakeholders consider necessary? Specifically, how would introducing a requirement for a judicial member, whether current or retired, to the Review Body (be it as a Deputy Chair or standing member) ameliorate concerns that the Review Body would not give due consideration to the legal issues? Is there a risk that this may create a pseudo Tribunal?

Impact analysis

10. What are the costs and benefits of each option for stakeholders? Do stakeholders agree with the risk and benefit analysis? Do stakeholders agree that the allocation of costs is

appropriate? Do stakeholders consider that overall costs of options 2 and 3 may be lower due to less reviews being conducted and in a less legalistic manner?

11. In assessing the overall costs of options 2 and 3, how might these be lower or higher that Option 1? For example, what impact would reducing the number of reviews or the changes from a legalistic approach have on costs?
12. How could currently covered Ministerial and NCC decisions be treated under each of the options? Would it be appropriate for such decisions to only be reviewable through judicial review?

Stakeholders are requested to provide a breakdown of the costs of the options, including operational costs, financing costs and disputation costs, in a separate, confidential document. SCO will aggregate any information on costs to gain an industry-wide perspective and the data will not be able to be attributed to any one entity.

Acronyms

ACCC	Australian Competition and Consumer Commission
AD(JR) Act	Administrative Decisions (Judicial Review) Act
AEAA	Australian Energy Appeals Agency
AEMA	Australian Energy Market Agreement
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
CALC	Consumer Action Law Centre
COAG	Council of Australian Governments
CPI	Consumer Price Index
ENA	Energy Networks Association
ERA	Economic Regulation Authority
ESAA	Energy Supply Association of Australia
FIG	Financial Investors Group
IPART	Independent Pricing and Regulatory Tribunal
MCE	Ministerial Council on Energy
NCC	National Competition Commission
NEL	National Electricity Law
NEM	National Electricity Market
NEO	National Electricity Objective
NER	National Electricity Rules
NGL	National Gas Law
NGO	National Gas Objective
NGR	National Gas Rules
RIS	Regulation Impact Statement
SCER	Standing Council on Energy and Resources
SCO	Senior Committee of Officials
SWIS	South West Interconnected System
WEM	Wholesale Electricity Market

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Purpose of Regulation Impact Statement

The purpose of this Regulation Impact Statement (RIS) is to test options for changes to the limited merits review regime that applies to regulatory decisions in the national electricity and gas markets. These options are based on the recommendations from an Expert Panel (the Panel) (refer to pages 5 and 6).

To provide certainty to all energy market institutions, participants and users, changes to the National Electricity Objective (NEO) and the National Gas Objective (NGO) (refer to Box 1) proposed by the Panel will **not** be considered through this process. Rather, noting the Panel's finding that the objectives are world's best practice, the Standing Council on Energy and Resources (SCER) does not intend to revise the objectives.

Box 1: National energy objectives

The regulatory framework for electricity networks and gas pipelines under the national energy laws is underpinned by key economic concepts, namely, the objective of the law, the revenue and pricing principles and the form of regulation. Both the National Electricity Rules (NER) and the National Gas Rules (NGR) are designed to support the achievement of these concepts.

For electricity, the National Electricity Law (NEL) states that the NEO is:

> "To promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to –
>
> 1. price, quality, safety, reliability, and security of supply of electricity; and
> 2. the reliability, safety and security of the national electricity system."

For gas, the National Gas Law (NGL) states that the NGO is:

> "To promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas."

In setting the regulatory determinations for regulated electricity networks and covered gas pipelines, the regulator must take into account the revenue and pricing requirements for the business, using the high level principles set out in the NEL and NGL, whereby a regulated network service provider should:

- be able to recover efficient costs;
- have adequate incentives to promote economic efficiency;
- obtain returns that are commensurate with risk;
- obtain returns where due regard is given to the costs and risks associated with under- or over-investment; and
- obtain returns where due regard is given to the costs and risks associated with underutilisation of the asset.

The Panel also made a number of recommendations around the broader regulatory framework:

- SCER task the Australian Energy Market Commission (AEMC) to review the existing rules to achieve greater consistency with the provisions in the NEL and NGL;
- introduce new requirements on network businesses to give greater consideration to consumer expectations in developing their business plans;
- establish the Australian Energy Regulator (AER) as an independent agency separate from the Australian Competition and Consumer Commission (ACCC);
- revisit the question of privatising publicly owned businesses;
- introduce more sophisticated network pricing and developments in demand management to reduce future network capital expenditure; and
- use lessons learned from energy market policy development to inform environmental policy development.

While SCER welcomes the Panel's work in these areas, it considers that these recommendations are outside of the scope of this RIS process.

Introduction

Consistent with best practice regulation under the national frameworks applying to the electricity and gas markets in Australia, there is an accountability mechanism that allows parties affected by decisions appropriate recourse for having those decisions reviewed on their merits. The objective of this is to ensure fair treatment for all persons or parties affected by a decision.

Details on Australia's electricity and gas markets are at *Appendix I*.

As required by the Administrative Review Council[5], the application of merits review is limited to administrative decisions, that is, ones that will, or are likely to, have direct bearing on the interests, including operation, of a particular party. For example, in the electricity and gas markets, a network regulatory determination will affect the revenues and operation of that network business and are, therefore, administratively reviewable and all such decisions should be open to review based on their merits.[6] Other decisions that have a wider application, such as changes to the rules or development of regulatory guidelines are not suitable for merits reviews.

The key objective of the regulatory framework governing electricity and gas markets in Australia is to promote the long term interests of energy consumers, through efficient investment in (that is, ensuring required investment represents the least cost over the long term for consumers) and use of energy infrastructure. In recognition of the impact of regulatory decisions made under this framework on the interests of all consumers, users and investors, it is important that parties affected by decisions have access to appropriate recourse in having the merits of these decisions reviewed.

Since 2008, two forms of review have been available in the electricity and gas markets; judicial review of all decisions and limited merits review of economic regulatory decisions and decisions around coverage of gas pipelines (more detail on these is set out below).

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[5] *The role of the Administrative Review Council is to ensure that the administrative decision-making processes of the Commonwealth Government are correct according to law and accord with administrative law values.*

[6] http://www.arc.ag.gov.au/Publications/Reports/Pages/Downloads/Whatdecisionsshouldbesubjecttomeritreview1999.aspx.

Background to this Regulation Impact Statement

In its 2006 *Review of Decision Making in the Gas and Electricity Regulatory Frameworks*, the Ministerial Council on Energy (MCE) maintained the position that the review mechanism should aim for the most optimal decisions possible where the benefits of delivering outcomes in the long term interests of consumers outweigh the costs of the review to stakeholders. The MCE determined the review scheme should:

- maximise accountability;
- maximise regulatory certainty;
- maximise the conditions for the decision-maker to make a correct initial decision;
- achieve the "best" decisions possible;
- ensure that all stakeholders' interests are taken into account, including those of service and network providers, and consumers;
- minimise the risk of "gaming"; and
- minimise time delays and cost.[7]

In establishing the limited merits review regime in 2008, the MCE agreed that a review of the effectiveness of the regime should be undertaken within the first seven years of the commencement of the relevant merits review provisions in the NEL and NGL (the Review). The requirement for the review was formalised by inclusion of provisions in the NEL and NGL.

The intention of the Review was to assess how the scheme has operated.[8] In particular, it was expected that the Review would examine:

- whether merits review has favoured any particular parties and if there is evidence of "gaming" by any parties;
- the cost implications for governments and parties;
- whether information disclosure and evidence restrictions have been effective;
- to what extent energy users and consumers have been able to participate;
- whether the Tribunal has acknowledged the expert knowledge developed by the primary decision-makers in remitting appropriate matters back to them;
- whether additional modifications are necessary to achieve the MCE's objectives in light of developments in the structure of the regulatory decisions themselves;
- whether the legislated framework for the merits review model could be improved; and
- whether the merits review scheme could be abolished, so that only judicial review would remain available to challenge the regulator's decisions.[9]

Growing debate on the effectiveness of the merits review framework led to the MCE's successor, the Standing Council on Energy and Resources (SCER)[10] deciding to bring forward this review. On 22 March 2012, it announced the establishment of an independent expert

[7] MCE, 2006; *ibid*.
[8] MCE, 2006; *Review of Decision-Making in the Gas and Electricity Regulatory Frameworks*, p 7.
[9] MCE, 2006; *ibid*.
[10] While the SCER has responsibility for policy development and reform in the electricity and gas markets, the MCE retains legal standing in the national energy legislation. In this document, the MCE is used to refer to Energy Ministers within the SCER and not a separate governance body.

panel (the Panel) of Professor George Yarrow as Chair, Dr John Tamblyn and the Hon. Michael Egan to undertake this review. In undertaking the review, the Panel was requested to advise the SCER on the performance of the regime against the 2006 MCE policy intent and, if necessary, make recommendations to better deliver the policy objective (details of this process are at *Appendix II*).

Expert Panel's Review of the Limited Merits Review Regime

On 9 October 2012, the Panel's Final Report for the *Review of the Limited Merits Review Regime* was published. The review was undertaken in two stages:

- Stage One - a preliminary assessment of the performance of the regime in the electricity and gas sectors against the original policy intent; and
- Stage Two - recommendations on whether amendments are required to better deliver against the objective of the review mechanism.

Both stages involved consultation on position papers, receiving submissions, stakeholder meetings and public forums. The documents released during the review are available on SCER's website: www.scer.gov.au.

Stage one

Broadly, the Panel found that the original MCE policy intention was sound and remains relevant; however, in its implementation, the regime had fallen short of the initial policy expectations in some important and key respects and a number of weaknesses and deficiencies with the regime were identified. The Panel found that the general approach for reviewing decisions was unduly narrow and was relatively detached from the promotion of the NEO and NGO, specifically the intention for regulatory decisions to be in the long term interests of consumers.

In particular, the Panel noted:

- the arrangements have not ensured that all stakeholders' interests have been adequately taken into account;
- consumer bodies and network user associations (with justification) feel excluded from the appeals process;
- the regime lacks "legitimacy" with important stakeholder groups;
- there does not appear to be great confidence in the regime as currently constituted;
- an informed consumer would find it very difficult to discover a credible account 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(1) of the NGL, which provide for the regulator to raise matters not raised by the applicant, have not been utilised; and
- the limited merit review regime has been costlier to operate and cases have taken longer than was anticipated at the outset.

Stage two

On the basis of the limitations identified, to support its work in stage two, the Panel developed more detailed objectives, namely, the appeal regime should:

- be capable of addressing issues on a sufficiently wide basis, up to and including the overall regulatory 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 processes itself, and should promote network service provider engagement with consumer requirements at all stages of regulatory decision making; and
- not be more protracted or demanding of resources than is necessary to achieve the fundamental purposes of merits review.[11]

Expert Panel's recommendations

To address the limitations in the existing regime, the Panel made a number of recommendations based on these objectives:

1. 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.
2. The words "in ways that best serve" be inserted for the word "for", before "the long term interests of consumers" in the NEO and NGO.
3. Appeals should only be allowed or 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 or 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.
4. 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').
5. The review body should adopt an investigative approach to reviews of the relevant decisions, and should be subject to specific duties.
6. Applications for review should be open to regulated network businesses, energy ministers, consumer or user representatives, and other parties with a sufficiently material interest in the decision.
7. 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 National Competition Council (NCC) and State Ministers in the gas and electricity areas should be reviewed via the same or via a separate process.
8. 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.
9. Time limits on hearing of appeals should be retained but relaxed.

11 Yarrow, Egan and Tamblyn; *Review of the Limited Merits Review Regime; Interim Stage Two Report*, 31 August 2012, page 7.

10. The appeals functions of the Tribunal should be transferred to a new review body that is fully administrative in character (i.e. is not a designated tribunal). For convenience, the Panel referred to this as the Australian Energy Appeals Authority (AEAA).
11. 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 team with relevant expertise, members of which may participate on a temporary or intermittent basis.
12. 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.
13. The host agency for the AEAA should be the AEMC.
14. 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.
15. The overhead costs of the review body should be shared among network service providers 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 network service providers, 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.

The Panel explicitly recommended against adopting a *de novo*[12] approach or limiting appeals to judicial review as a means of addressing the limitations to the regime.

While the Panel has made a number of detailed recommendations, at a high level, SCO considers that the key proposals relate to the review framework (that is, the requirements set out in the NEL and NGL, in particular, the ground for review) and the institutional arrangements. Through this RIS, SCO is seeking feedback on these issues through different options.

Related changes

Parallel to the Panel's review of the limited merits review regime, the AEMC considered the framework for economic regulation of network service providers. On 29 November 2012, the AEMC published its final determination for a range of changes to the NER and NGR (collectively, the rules) on the economic regulation of network service providers to achieve efficient outcomes in setting revenues and prices for network businesses. These changes to the rules will improve the strength and capacity of the regulator to carry out its functions in approving future spending by network businesses. Specifically, the changes give the regulator greater discretion to question businesses expenditure forecasts and provide flexibility for the regulator to adapt its approaches to the nature of the business it is regulating and improve consumer engagement in the decision making process.

All economic regulatory decisions made by the AER from May 2014 onward will be carried out in accordance with the new rules.

Given the new rules will be in operation by the start of the next regulatory period, these changes to the rules will be viewed as business as usual and therefore apply to all of the options in this RIS. Consequently, this RIS will focus solely on the problems associated with the limited merits review regime, and on options to improve its performance.

[12] *De novo* review relates to making the whole decision again on the facts.

Other relevant reform processes foreshadowed in the 23 November 2012 SCER meeting that are currently being progressed to improve the regulatory framework for energy markets include:

- measures to strengthen the regulator, in the areas of resourcing, performance and accountabilities; and
- the establishment of a consumer panel to prosecute consumers' views in the regulatory process for network pricing decisions, including subsequent appeals.

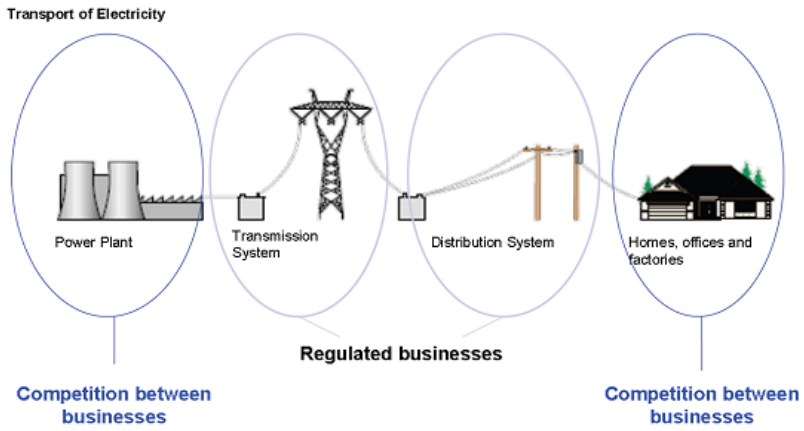
In addition to SCER's intentions to reform the performance and accountability for the AER (noting that Ministers are continuing to discuss issues around governance and funding), the Australian Government has committed to additional funding to enable the AER to undertake its energy market functions effectively as well as to improved budget transparency and performance reporting to improve accountability.

The Australian Government has committed to undertake an independent review of the AER and its operational requirements, within the scope of the current organisational structure, in 18 months' time to ensure resourcing is adequate, and the operational arrangements are effective, to meet the demands of the new regulatory regime drawing on the experience of the intervening period.

Background context for limited merits review

The limited merits review regime applies to certain regulatory decisions under the NEL and NGL. The most commonly appealed decisions relate to economic regulatory decisions on monopoly network businesses. Generally, competitive components of the energy supply chain are linked by natural monopoly networks (Figure 1 provides an example for electricity).

Figure 1: Competitive and regulated businesses in the electricity supply chain



Energy networks are capital intensive and incur declining average costs as output increases. This means network services in a particular geographic area can be most efficiently served by a single supplier, leading to a natural monopoly industry structure. In Australia, the networks are regulated to manage the risk of monopoly pricing.

In regulating network businesses, it is important to recognise that the intention is to maintain the price, quality, safety, reliability, and security of supply of electricity and gas for consumers over the long term. In this, price is only one component and it is important not to confuse efficient outcomes with short term price impacts.

Electricity

Regulated electricity network businesses in the National Electricity Market (NEM) must periodically apply to the AER to assess their revenue requirements (typically, every five years)[13]. Based on this proposal, the AER must forecast the revenue requirement of a business to cover its efficient costs and provide a commercial return. It uses a building block model that accounts for a network's efficient operating and maintenance expenditure, capital expenditure, asset depreciation costs and taxation liabilities, and a commercial return on capital. All the revenues for network businesses are recovered from consumers in the network tariff portion of their electricity bills.

The largest component of this revenue is the return on capital, which may account for up to two-thirds of revenues. The size of a network's regulated asset base (and projected investment) and its weighted average cost of capital (the rate of return necessary to cover a commercial return on equity and efficient debt costs) both influence the return on capital. An allowance for operating expenditure typically accounts for a further 30 per cent of revenue requirements.

New investment in infrastructure is needed to maintain or improve network performance over time. Investment includes network augmentations (expansions) to meet rising demand and the replacement of ageing assets.

The regulatory process aims to create incentives for efficient investment. At the start of a regulatory period, the AER approves an investment (capital expenditure) forecast for each network. It can also approve contingent projects — large investment projects that are foreseen at the time of a determination, but that involve significant uncertainty. While the

[13] The electricity networks that make up the South West Interconnected System (SWIS) in Western Australia are regulated by the Economic Regulation Authority under a separate regulatory framework to the NEL.

regulatory process approves a pool of funds for capital expenditure, under separate processes in the NER, proposed major projects must be assessed through a regulatory test for whether it represents the most efficient way of meeting an identified need, or whether an alternative (such as investment in generation capacity) would be more efficient.

Gas

The NGL and NGR set out the regulatory framework for the gas sector. These apply economic regulation provisions to covered pipelines. Various tiers of economic regulation apply, based on the level of competition and significance criteria.

Seven transmission pipelines are subject to full regulation, which requires a pipeline provider to periodically submit an access arrangement to the regulator for approval. An access arrangement sets out the terms and conditions under which third parties can use a pipeline. It must specify at least one reference service likely to be sought by a significant part of the market, and a reference tariff for that service. The regulator assesses the revenues needed to cover efficient costs (including a benchmark return on capital), then derives reference tariffs for the pipeline. The NGR allow for income adjustments from incentive mechanisms to reward efficient operating practices.

Most Australian gas distribution networks are subject to full regulation. Access arrangements are approved for these networks by the regulator typically for periods of five years, under processes similar to that for transmission pipelines. The regulatory process under the NGR employs a building block approach to determine total network revenues and derive reference tariffs. The NGR also allow for income adjustments from incentive mechanisms that reward efficient operating practices. In a dispute, an access seeker may request the regulator to arbitrate on and enforce the terms and conditions of the access arrangement.

Differences in electricity and gas

There are important differences in the economic regulation of gas and electricity network businesses. For electricity, the process by which the regulator must make its regulatory determination is specified in detail. As merits review is open for the entire regulatory determination, each component decision of the entire determination is open to review.

By contrast, for gas, the regulator makes a determination on the access arrangements. Under this approach, the reviewable decision is the overall determination.

Predominantly the customers of gas transmission pipelines are major users (whereas the vast majority of electricity transmission and distribution services are purchased by retailers) and tend to be large, sophisticated parties that are able to engage closely with the network businesses and in the regulatory processes. These consumers tend not to face similar barriers to participation as the comparatively smaller electricity users. Consumer participation issues in respect of the review process may differ between the fuel types.

However, the SCER remains committed to a common approach to energy access, which it identified in the MCE's December 2003 report to COAG. The purpose of this approach is that, to the extent feasible and where effective regulation is not impeded, there should be consistency and harmonisation between electricity and gas access regimes such that investment in, and use of, energy is not distorted by differing regulatory regimes.

In addition, while consumer engagement in the review process is one of the issues identified by the Panel, it is not the only regulatory failure associated with the review process. Consequently, SCO does not intend to consider gas reviews separately from the broader debate on the limited merits review regime.

Merits review of electricity and gas decisions

Merits review is where the relative merits of the decision are assessed and, if a "correct or preferable" decision is established, the decision is remitted to the primary decision maker or an alternative decision is substituted for the initial decision. Merits review is limited to those decisions that affect a specific party and not sector-wide decisions.

As set out in the Australian Administrative Law Policy Guide, merits review is the process by which a person or body, other than the primary decision maker, reconsiders the facts, law and policy aspects of the original decision and determines the "correct or preferable decision". This form of review can be of all the aspects of the decision, where the review body remakes the original decision on the basis of the facts, the policy, the reasoning and the law in front of the original decision maker (known as *de novo* review) or it can be limited to only considering some aspects of a decision.

The distinction between "correct or preferable" in relation to a decision is important. A "correct" decision is only able to be made with respect to non-discretionary matters where only one decision is possible, on either the facts or the law. However, where a decision requires the exercise of discretion or a selection between possible outcomes, judgement is required to assess which decision is "preferable".

It is also important to recognise that the Tribunal is not a court. It is created under statute and derives its functions and powers solely from legislation. In this way, under the current framework, the Tribunal is expected to operate in accordance with the requirements under the NEL and NGL, although these processes must be consistent with its role as set out in the *Competition and Consumer Act 2010*.

The limited merits review regime was introduced under the NEL on 1 January 2008 and under the NGL on 1 July 2008. The limitation in the merits review relates to the applicant being required to establish grounds of review based on regulatory errors of fact or discretion[14] and demonstrate there is a serious issue to be heard. In addition, merits review is limited to the information before the original decision maker and to the aspects of the decision that form the review.

It is important to note that all decisions made under the national energy laws are able to be appealed through judicial review, where the appellant can demonstrate that they have exhausted all other appeal avenues.

Judicial review is an assessment of whether due process has been followed and the decision is within the legal bounds prescribed by the relevant law. This usually consists only of a review of the procedures followed in making the decision. Judicial reviews are heard by the Federal Court.

Judicial review is brought before a court which then determines whether the decision appealed against is unlawful and of no effect. The court then exercises its discretion regarding whether or not to grant relief. The court usually has no power to review the decision "on its merits" and determine whether or not it was the decision the court would have made. The court only has the power to review the decision to see whether the decision-maker made the decision lawfully.[15]

Where these decisions are based on provisions set out in the rules, the rules themselves will influence outcomes in the appeal regime. That is, the interpretation and application of the provisions may give rise to challenges through the Tribunal under a limited merits review regime.

[14] NEL s 71C and NGL s246.
[15] http://www.lawhandbook.org.au/handbook/ch21s01s01.php

Operation of the limited merits review framework

In 2011, combined network revenues were forecast at almost $58 billion over the current cycle, comprising over $12 billion for transmission and $46 billion for distribution. Average revenues are forecast to rise by around 43 per cent (in real terms) above levels in the previous regulatory periods. The main drivers are higher capital expenditure (investment) and operating costs, and higher capital financing costs. [16]

A limited merits review is triggered when an affected or interested party seeks leave from the Tribunal to appeal a decision that is covered under the framework. The Tribunal will then decide whether the appellant has established a ground for review, and (if this ground is established) will then assess whether that decision was 'correct or preferable' by effectively 'standing in the shoes' of the original decision maker.

Between June 2008 and October 2011, network businesses sought review of 16 AER determinations; three on electricity transmission networks, 11 on electricity distribution networks and five on gas distribution networks. There were also two reviews of AER determinations on advanced metering infrastructure (smart meter) charges for Victorian networks. As of October 2011, all but one network business had appealed the AER's determinations. [17]

The decisions on these reviews have increased allowable network revenues by approximately $2.9 billion, with substantial flow-on impacts on retail energy charges. Based on Ernst and Young estimates, the Panel estimated a total revenue impact of Tribunal decisions of around $3.6 billion over a five year period. [18] The most significant contributors to this increase were Tribunal decisions on:

- the averaging period for the risk free rate (an input into the weighted average cost of capital) – reviewed for four New South Wales and one Tasmanian network, with a combined revenue impact of $2 billion; and
- the value adopted for tax imputation credits (gamma), which affects the estimated cost of corporate income tax – reviewed for two Queensland and one South Australian distribution network, with a combined revenue impact of $780 million.[19]

The Tribunal handed down decisions in 2011 on reviews for Energex and Ergon Energy (Queensland) and ETSA Utilities (South Australia). The decisions increased the electricity distribution networks' allowable revenues by around $850 million (including the $780 million gamma component), which amounted to a 5 per cent increase in total revenue over the regulatory period. Following the decisions, the Queensland Government, as the owner of the network businesses, intervened to prevent Energex and Ergon Energy from recovering the additional revenue allowances determined by the Tribunal.[20]

Without judging the correctness of either the AER or the Tribunal's decisions, SCO considers the number of reviews indicates the limited merits review regime has become an extension of the regulatory determination process, contrary to its intended operation. The reason for this may relate to a number of factors, such as the AER being unable to take into account precedents or perhaps practical difficulties in pricing reasonable overall costs using a bottom up process. However, it is reasonable to question, on the basis of the number of reviews of decisions on contentious matters of a highly subjective nature, whether such appeals have focussed on the long term interests of consumers.

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[16] AER, ibid.
[17] AER, State of the Energy Market 2011.
[18] Ibid.
[19] AER, State of the Energy Market 2011.
[20] Ibid.

SCO notes that frequent appeals increase costs for market participants (and ultimately consumers) and suggest that something is not working well in the overall regulatory process. Successful appeals suggest a level of regulatory error but also that the regulatory framework is subject to differences in interpretation by the regulator, network businesses and the Tribunal. In addition, frequent appeals suggest that there may be an imbalance in the regime that incentivises network businesses to appeal decisions.

In its Stage One Final Report, the Panel found that in the period from the commencement of the regime in January 2008 to 29 February 2012, the Tribunal issued 40 separate decisions in relation to the electricity and gas markets, of which some 22 decisions involved matters of a substantive nature (that is, they were not decisions on questions of leave to appeal, or other procedural matters). [21]

Of the 22 decisions involving matters of a substantive nature, 13 decisions related to regulated rate of return parameters and 11 of these resulted in an AER determination being varied and/or remitted for consideration. Of the 9 cases in which rate of return parameters were in dispute, only one case resulted in the original AER determination being affirmed in full. [22]

The Panel estimated that Tribunal decisions led to increases in electricity transmission charges of 10 per cent and average increases in distribution charges of 9 per cent in New South Wales over the 5 year regulatory period, meaning that the effect of Tribunal decisions on the end retail price would be around 4.2 per cent over the regulatory period.[23]

An equivalent example in South Australia is that SA Power Networks applied to the Tribunal for a review of the value of imputation credits (gamma) and the value of its opening regulatory asset base. The Tribunal allowed for an additional $301 million to be recovered over the current regulatory period, that is, about a 5 per cent increase in total revenues over the regulatory period. Distribution network charges make up around 40 per cent of the typical residential customer's electricity bill; while the impact of the Tribunal's decisions varies between businesses; this was an increase from 5.75 to 8.25 per cent in the average annual changes in real network charges for South Australia.[24]

Clearly, the effects of Tribunal decisions on regulatory determinations can be matters of material consequence for network users, end consumers and network service providers, and to the achievement of the NEO and NGO. Equally clearly, these decisions have fundamental long term implications for the effectiveness of the energy regulatory framework. SCO considers that, where appeals become a routine part of the regulatory process, this could undermine the validity of wider market frameworks or the regulators' role outside of economic regulation.

Table 2 provides a breakdown of the drivers behind electricity price increases in Australia to provide context around the effect of decisions relating to network revenues on retail prices.

21 Yarrow, Egan and Tamblyn; *Review of the Limited Merits Review Regime; Stage One Report,* 29 June 2012.

22 Ibid.

23 Yarrow, Egan and Tamblyn; *Review of the Limited Merits Review Regime; Stage One Report,* 29 June 2012, p 21

24 AEMC, *Future Possible Retail Electricity Price Movements: 1 July 2011 to 30 June 2014*, December 2011.

Table 2: Comparison of electricity price increases and contribution of components to electricity price increases[25]

	National	ACT	Victoria	Tasmania	South Australia	Western Australia	Northern Territory	Queensland	NSW
Total price comparison:									
2010/11 price (c/kWh)	22.41	16.19	22.86	20.75	23.99	23.99	23.76	20.69	22.75
2013/14 price (c/kWh)	30.75	22.93	30.32	25.94	32.67	31.26	27.65	29.28	32.27
Total c/kWh increase	8.34	6.74	7.46	5.19	8.68	7.26	3.89	8.59	9.51
Total % increase (2010/11 to 2013/14)	37.2%	41.6%	32.7%	25.0%	36.2%	30.3%	16.4%	41.5%	41.8%
By component:									
Transmission	6.0%	6.1%	0.1%	15.4%	10.7%	13.2%	0.0%	6.0%	6.2%
Distribution	33.6%	14.2%	15.3%	22.5%	39.9%	43.5%	22.0%	40.2%	36.1%
Wholesale	40.2%	68.5%	40.4%	50.5%	34.8%	36.7%	68.0%	44.3%	38.3%
Retail	12.1%	7.1%	31.5%	11.9%	2.7%	5.9%	1.6%	8.4%	7.1%
Feed-in tariff	2.8%	3.9%	0.7%	0.0%	6.6%	0.0%	0.0%	0.2%	6.1%
LRET	3.8%	2.7%	3.8%	2.5%	5.1%	4.9%	12.4%	3.1%	3.7%
SRES	-0.8%	-2.3%	-2.0%	-2.9%	-1.8%	-2.1%	-4.0%	-1.6%	1.6%
Energy efficiency and demand management schemes	2.5%	-0.2%	10.2%	0.0%	2.0%	0.0%	0.0%	-0.6%	0.8%
Other state based schemes	-0.2%	0.0%	0.0%	0.0%	0.0%	-2.2%	0.0%	0.0%	0.0%
Carbon impact (c/kWh):									
2012/13	1.65	2.41	1.43	1.13	1.18	1.43	1.53	1.84	1.94
2013/14	1.76	2.47	1.45	1.12	1.21	1.83	1.53	1.93	2.03

[25] AEMC, *Future Possible Retail Electricity Price Movements: 1 July 2011 to 30 June 2014* , December 2011.

Statement of problem

The Panel's review found that the limited merits review regime has not delivered on the NEO, NGO or the original policy intention of the MCE to date.

In particular, the Panel stated that the limited merits review regime has adversely affected consumer interests in the short run through higher network charges and higher energy prices. The Panel identified that there was no evidence of countervailing consumer benefits in the longer term consistent with the NEO and NGO, which is potentially a significant deficiency in the performance of the current regulatory framework.

In short, the Panel established that the current limited merits review scheme is not delivering the NEO or NGO, in part due to the review regime not taking into account the effect of changes on the regulatory determination as a whole.

The current review approach adopted by the Tribunal, which has been based chiefly on testing whether the regulator did or did not correctly comply with the rules, is very close to a process of judicial review. In its decision to introduce a limited merits review regime in 2006 the MCE had not intended for merits review to be akin to judicial review.

The Panel considered that, consistent with the policy intent and the NEL and NGL, the fundamental premise for any decision should be whether it was justified in terms of the NEO or NGO. If the answer had been no, the Panel was of the view that the Tribunal should have desisted from making 'error corrections' that would likely detract from achievement of the NEO and NGO. However, as set out in its Final Report, the Panel found that the Tribunal is not in a position to reconsider the whole of the AER's decision due to limitations in the NEL and NGL and because of the nature of the operations and legal culture of tribunals *per se*, meaning that the scope of reviews of regulatory decisions is unduly narrow and not consistent with the original policy intention.

Box 2 indicates the concerns identified by the Panel relative to the objectives specified by the MCE.

Box 2: Issues identified by the Expert Panel

In relation to the specific objectives identified by the MCE in 2006, the Panel identified the following concerns:

- accountability: while the limited merits review has provided greater accountability for the AER, the position in relation to the accountability of the Tribunal is less clear. In particular, the Panel found that the Tribunal is not able to account for its more technical decisions in a way that is readily understandable to the public and stakeholders;
- regulatory certainty: over the long term, regulatory uncertainty will increase, in the absence of measures to ensure that the regime is robust and has the confidence of all stakeholders. This is in part because, in the longer term, it is likely that there will continue to be sustained upward pressure on energy costs due to investment undertaken in the current regulatory cycle as well as necessary new investment, which will in turn increase policy pressures around the structure of the regime;
- obtaining correct initial decisions: there is a lack of evidence to demonstrate major improvements in the way that the AER has conducted its business as a result of the regime; decisions by the AER continue to be routinely appealed, with these appeals generally successful;
- best possible decisions: there may be barriers to the Tribunal in reaching the best possible decisions, in that the regime does not explicitly require the resulting decisions to be justified on the basis of whether they contribute to the NEO and NGO. While the current regulatory arrangements are intended to provide a number of checks and balances against undue tendencies or biases in final decisions, the Panel found that these checks and balances have not been working well and it is difficult to argue that limited merits review has contributed to preferable decisions. This is particularly the case in relation to those cases concerned with cost of capital issues;
- all stakeholders' interests: the legalistic approach taken by the Tribunal to reviews is a barrier to participation in the process, in particular for consumer and user groups as the Tribunal is unable to adequately take into account the positions of stakeholders. Consumer and user groups feel the appeals process is a risky, costly and hostile environment for the expression of their views. Government representatives are also frustrated about their ability to participate in the Tribunal process. There is one instance where, in direct response to a decision by the Tribunal, state legislation was introduced to negate the impact of a Tribunal decision on consumer prices;
- gaming: while the Panel did not identify instances of gaming in the regime to date, they did raise concerns that, should the regime not be amended, there was a significant risk that network businesses could opportunistically use the limitations as a wealth transfer. This is due to the considerable financial incentives for network businesses to appeal; and
- delays and costs: the MCE's original policy intention to keep delays and costs low has not been realised in practice. Reviews have frequently lasted longer than the time periods contemplated and, in some cases, have been comparable to judicial review.

Evidence of regulatory failure

SCO agrees that the review arrangements that are currently in place have delivered outcomes that are both inconsistent with the original policy intent and the overarching objectives of the national energy markets. In this respect, SCO considers that the Panel has provided evidence of regulatory failure, specifically around delivering the MCE's policy intention, the unduly narrow focus of the reviews, accessibility to participation in review for all covered stakeholders and the timeliness of the regime.

Failure to deliver the policy intention

The objective of merits review is to ensure that administrative decisions are correct or preferable. As most reviews taken to the Tribunal relate to differences of opinion on components of a final decision, the Panel's finding that the Tribunal's focus tended to be on 'error correction' with respect to those components as individual matters indicates a failure to take into account the highly complex inter-linkages and contentious nature of the issues being reviewed.

Generally, on appeal, network businesses have, most often, been successful on the ground that the regulator's decision was unreasonable. For example, in four of the five cases dealing with the debt risk premium, applicants were successful on the 'unreasonableness' ground. The other ground of review on which applicants have tended to succeed is the 'incorrect exercise of discretion' ground. While these grounds are appropriate under the current arrangements, decisions have not been made with reference to the overall effect on consumers, in terms of their long term interests as set out in the national energy objectives.

As an example, from the Tribunal's decisions, the rate of return for network businesses has been increased to about 10 per cent (noting there are some differences between different businesses). While SCO is not in a position to comment on the appropriateness of the allowed rate of return for network businesses, it notes that this is higher than the AER's initial determination, which in turn was higher than the allowed rate of return previous jurisdictional regulators had set in their regulatory decisions. Excessively high rates of return on regulated assets deliver windfall profits and stimulate inefficient over-investment at the expense of consumers. As consumers ultimately bear the costs associated with the increase in revenue and future investment, it is important that these decisions can be demonstrated as being in the long term interests of consumers.

In establishing the regime, the intention was for the review process to be used rarely and only to address issues with a material consequence in the context of delivering the NEO or NGO, and meeting the revenue and pricing principles. However, the error correction approach adopted by the Tribunal may be leading to more appeals than would otherwise be the case. As noted by the Panel, international experience suggests that focusing on error correction in the appeals process correlates with high levels of appeal activity.

Narrow focus

Based on evidence provided by the Panel on the type of appeals before the Tribunal, rather than being a means of ensuring an accountable and high performing regulator, network businesses have used the regime as a means of litigating components of the initial decision where there is disagreement with the approach taken by the regulator, where that approach involves the regulator applying its judgment and discretion in setting that component, and doing so in its context as part of a broader decision.

Also, the Panel found that the review process is much more narrowly focused than was the original policy intention. The original intention, as set out in s71(O) of the NEL and s258 of

the NGL, was to allow the regulator to raise issues that could impact on the matter before the Tribunal. In practice, this has not occurred. As noted in advice from the Acting Solicitor General to the Panel, these clauses do not allow the Tribunal or regulator to expand the matter being reviewed beyond the ground for review.

Accessibility

The current reviews process has involved only certain parties being able to participate effectively, due to the high costs and risks involved. Due to the significance of the network revenues being disputed, network businesses have strong incentives to appeal. Consequently, the risk is that appeals will only be raised in expectation of decisions that benefit network businesses and not consumers. Further, given the current legalistic approach adopted by the Tribunal, consumer groups face significant barriers to participation, not least of which is associated with cost.

As the primary beneficiary of regulatory decisions and the parties that ultimately have to pay for any costs associated with those decisions, it is important that consumers are able to be heard in the entire regulatory process. It is a failure of the regime as currently structured when consumers are unrepresented in the review process, due to cost, technical capacity and legal representational barriers.

In addition, the outcomes of reviews have direct implications for consumers, it is important that these decisions are able to be understood. The failure to articulate what decisions mean for consumers and how it is in their long term interests makes the regime less accessible to all affected parties. Where there is a lack of understanding about such decisions, it is difficult to hold the decision-making bodies accountable.

Timeliness

Completion of the review within three months was a key aim of merits review, with the provision to extend this time if the particular case warranted it. As recognised by the Panel, a number of reviews have gone beyond the expectation of three months for a review, with some taking a similar amount of time to judicial review, which may take years.

The Panel suggests the review process needs to effectively balance the trade-offs between taking the time for reaching the most robust decision with the need for a timely decision to reduce uncertainty for network businesses about the outcomes and the potential for unnecessary price spikes for consumers. Given the consequences around extensive delays on both network businesses and consumers, this represents a failure of the framework to deliver its intention.

Objective

The objective of the limited merits review regime is to improve the accountability, transparency, efficiency and accessibility of decision making. This objective must be delivered in the context of the overarching objective for the regulation of energy network businesses; that is to ensure that regulatory decisions deliver the NEO or NGO, and are consistent with the underlying revenue and pricing principles. In this regard, the NEO and NGO are the primary objectives and are spelled out in their respective laws.

In light of the Panel's recommendation that SCER provide a clear statement of policy intent on the limited merits review regime, SCO, consistent with the MCE's original policy intention, confirms and clarifies that the limited merits review regime should:

- provide a balanced outcome between competing interests and protect the property rights of all stakeholders by:

  - ensuring that all stakeholders' interests are taken into account, including those of network service providers, and consumers; and
  - recognising efforts of stakeholders to manage competing expectations through early and continued consultation during the decision making process;
- maximise accountability by:
  - allowing parties affected by decisions appropriate recourse to have decisions reviewed.
- maximise regulatory certainty by:
  - providing due process to network service providers, consumers and other stakeholders; and
  - providing a robust review mechanism that encourages increased stakeholder confidence in the regulatory framework
- maximise the conditions for the decision-maker to make a correct initial decision by:
  - providing an accountability framework that drives continual improvement in initial decision making;
- achieve the best decisions possible by:
  - ensuring that the review process reaches justifiable overall decisions against the energy objectives;
- minimise the risk of "gaming" through:
  - balancing the incentives to initiate reviews with the objective of ensuring regulatory decisions are in the long term interests of consumers; and
- minimise time delays and cost by:
  - placing limitations on the review process that avoid or reduce unwarranted costs and minimise the risk of time delays for reaching the final review decision.

In this context, SCO recognises that there is the potential for the misinterpretation of 'the long term interests of consumers' to focus on short term price increases. While price should always be a factor taken into account when considering the long term interests of consumers, SCO notes that is in the context of whether changes in prices represents efficient outcomes for the long term interests of consumers.

An aspect of the network businesses' operations that has implications for the long term interests of consumers is the confidence of investors in the regulatory regime. The timely provision of network infrastructure to meet growing demand and expectations around reliability is in the interests of consumers. Consequently, investor certainty will be one of the considerations of the SCER in developing a policy position on reforms to the review regime.

Options

The Panel's recommendations represent significant changes from the existing arrangements. To fully explore the implications of these changes, SCO will explore three options:

1. Option 1: the status quo;
2. Option 2: amendments to the framework and with the retention of the Australian Competition Tribunal (the Tribunal) as the Review Body; and

3. Option 3: amendments to the framework and establishment of a new Review Body, consistent with the Panel's recommendations.

These options represent a suite of possible amendments to the framework, ranging from maintaining the current arrangements through to full implementation of the Panel's recommendations. The purpose of this document is to test these amendments with stakeholders to determine what the effect of each of the detailed areas underpinning the options would have on all stakeholders.

In providing feedback on these options, stakeholders should note that, for the purposes of this consultation, Option 3 is the 'preferred option' of the Panel. In making this statement, SCO recognises the importance of testing the details underpinning the Panel's recommendations and that option 2 is a subset to the range of changes set out in Option 3.

SCO has considered the potential for a fourth option, which would be to remove access to any form of merits review, that is, allow access to judicial review only. Under this approach, the Federal Court would review the decision-making of the primary decision maker in the context of specific requirements set out in the NEL and NGL and would review compliance with those legislative requirements in relation to both the process followed by the decision-maker and the decision made. As noted above, judicial review is available for all decisions made under the NEL and NGL, although this is subject to all avenues for appeal being exhausted in the first instance.

Under the judicial review only approach in relation to the electricity and gas regulatory determinations, the Federal Court would be able to go beyond considering procedural fairness and jurisdiction if there are specific requirements in the NEL and NGL. As a result, regulatory errors that have adverse economic effects will be more readily corrected than would otherwise be the case.

However, SCO does not intend to consider this option further. SCO considers that judicial review without a complementary merits review scheme in place is not sufficient to achieve the MCE's policy objectives. This is consistent with the MCE's position in its 2006 Decision Paper and the advice from the Panel in its Final Report.

In particular, the Panel emphasised that merits review has an important role to play in the economic regulation of energy network businesses. Currently, the regulator can exercise significant discretionary powers, which need to be balanced by adequate recourse to appeal. This is unlike regimes where the primary regulator simply follows prescriptive processes, where errors in law can be readily proven. Accordingly, judicial review alone would be unable to provide sufficient accountability for affected parties, that is assessing the merits of the initial decision.

The potential for judicial review to take longer than merits review, with consequent delays in finalising the determinations in question, could have implications for network providers and investors, reducing the certainty required to make significant investments. In addition, a move to judicial review only also would not address the concerns raised by the Panel that consumers face significant barriers to participation in the review process – in fact, this option could make the review regime more inaccessible for consumers, by raising the costs, including legal costs, of applying for or participating in a review, and increasing the legal formality of the review process.

From a legal perspective, there would be limitations on matters that could be appealed under a judicial-only approach, particularly in relation to assessing the merits of an administrative decision. Judicial review only looks at the correctness of the procedures in law and does not allow for the substitution of correct or preferable decisions. It may allow a decision to endure which imposes significant costs on users of electricity and gas, and

therefore society as a whole or provide insufficient return to network providers for them to invest in required infrastructure, potentially leading to reliability and security risks for consumers.

- Do stakeholders agree access to merits review should be maintained? Stakeholders may wish to offer comment on their reasons for wishing to pursue or not pursue this alternative.
- Do stakeholders consider that a consistent approach to limited merits reviews of electricity and gas regulatory decisions remains appropriate? Please provide your reasoning for this position.

Option 1: Status quo

This option retains the current framework that is set out in the NEL and NGL and the Tribunal as the review body for all reviewable decisions. That is, no change to the current review arrangements.

The key attributes of the review framework are:

- allowing limited merits review by the Tribunal of certain regulatory decisions where, in this process, the Tribunal has the functions and powers of the original decision maker;
- the applicant, an affected or interested party, must seek leave from the Tribunal to bring a review based on certain criteria;
- the applicant must establish one or more of four grounds of review based on regulatory errors of fact or discretion, or unreasonableness, and demonstrate there is a serious issue to be heard;
- the AER may raise a matter not raised by the applicant or an intervener and may raise a possible outcome or effect that may occur as a consequence of the Tribunal varying or setting aside a determination;
- a regulated network service provider or a Minister of a participating jurisdiction may intervene in a review without leave of the Tribunal, and the Tribunal may grant leave to intervene to a user, consumer or a person or body who is a reviewable regulatory process participant;
- an intervener may raise new grounds not raised by the applicant, although a party, other than the AER, may not raise any matter that was not raised in submissions to the AER before the reviewable regulatory decision was made;
- the Tribunal must not consider any matter other than review related matter;
- an applicant has 15 business days to bring an application for review; and
- the Tribunal has a time limit, after granting leave, of three months (which may be extended) to determine the review.

Under this framework, the review is limited by only looking at certain aspects of a decision where a ground for review has been established, the material the Tribunal can consider before a ground for review has been established and the time required for the Tribunal to complete its processes.

Reviewable decisions under this framework are:

- Ministerial decisions in relation to coverage of gas pipelines (including binding no-coverage determinations);
- Decisions by the NCC on the form of regulation to apply in gas;
- AER[26] decisions to draft and approve (or revise) gas access arrangements;
- AER ring fencing decisions, including non-approval or voiding of associate contracts, in gas;
- AER pricing and revenue determinations for transmission and distribution in electricity (including application of regulatory test); and
- AER decisions not to exempt entities from ring fencing guidelines or impose additional ring fencing requirements, in electricity[27].

There have been a number of recent announcements that have implications for the operation of the review framework including:

- the 29 November 2012 publication of the AEMC's final determination for the *Economic Regulation of Network Service Providers Rule Change*; and
- the 23 November 2012 SCER announcement of its commitment to strengthening economic regulation.

For the purposes of this consultation, the status quo reflects these changes being in place. Therefore, the focus of any stakeholder feedback should be based on these factors as a starting point.

- Are there any minor amendments to the NEL or NGL that could address the problems identified by the Panel?
- To what extent do recent reforms, most notably recent network regulation rule changes, address the concerns identified by the Panel?

Option 2: Amendments to the merits review framework while retaining the Tribunal as the review body

This option is a substantial change to the status quo outlined above, with those amendments to the framework proposed by the Panel that could be introduced in the absence of the establishment of a new review body.

As discussed below, recommendations from the Panel that cannot be implemented with the retention of the Tribunal as the review body have been modified to reflect this difference. Consequently, this option gives effect to the following of the Panel's recommendations:

- Appeals should only be allowed or upheld if, on the basis of relevant evidence and substantiated reasoning, the Tribunal is convinced that there exists a materially preferable decision.
- There is only to be a single ground for appeal: there are reasons for believing a relevant decision may be defective in that a materially preferable decision may exist and the

[26] In the case of Western Australia, the relevant decision-maker is the ERA.
[27] In the Northern Territory and Western Australia the model applies to gas access matters.

primary regulator's decision does not promote economic efficiency for the long term interests of consumers.

- The Tribunal will assess whether a materially preferable overall decision is available with specific reference to the NEO and NGO; that is, specific issues or errors raised by the appellant may be considered in the context of the impact on the overall decision.
- Applications for review should be open to regulated network businesses, energy ministers, consumer and user representatives, and other parties with a sufficiently material interest in the decision.
- The same body should handle the review of all decisions where the AER is the primary decision maker.
- 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.
- Time limits on hearing of appeals should be retained but extended from 3 to 6 months.

The Panel made additional recommendations to change the review framework to address some of the key barriers to consumer engagement in the review process. However, as noted above, these would not be feasible given the structure of the Tribunal. In light of the Panel's identification of barriers to the delivery the MCE's policy intention, the following modifications to the Panel's recommendations are incorporated into this option:

- The review should be purely administrative and not adversarial or judicial in nature, with consumer views being routinely invited during the review process, where this does not amount to the admission of new information.
- The Tribunal would approach this process in accordance with specified duties, including:
  - Deciding whether a ground for review has been established and, if so, to open a review.
  - Adopting the 'record' of the primary decision maker as the starting point for its own review.
  - Publishing a practice note outlining its processes.

Under this framework for regulatory determinations, consistent with the Panel's recommendations, an appeal could be lodged on the basis that the appellant has reasonable evidence that there is a more correct or preferable underlying component or components to the regulatory determination (or 'decision') that could lead to a more preferable overall decision that is in the long term interests of consumers. This approach still allows 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. However, in raising these points the interested party must demonstrate that a materially preferable overall decision exists.

As with the status quo, it would be for the Tribunal to determine whether a ground for review has been established, that is, a materially preferable decision may exist. The criteria for judging whether one decision is preferable to another should be identical to those of the primary regulator – namely the NEO and NGO, and the revenue and pricing principles.

However, in making its decisions around both the ground for review and what a materially preferable decision would be, the Tribunal is able to seek input from the primary decision maker, the relevant network service provider, a Minister of a participating jurisdiction, and a user, consumer or a person or body who is a reviewable regulatory process participant

where it has established there is a sufficiently material interest, where they have nominated an interest in participating in the review process (referred to as 'interested parties'). The Tribunal would also be able to use concurrent evidence, where two or more experts give evidence at the same time and experts can listen to, question and comment on the evidence of the other expert(s). It would be at the discretion of the Tribunal as to how it would conduct the review, but it would be required to be administrative and not judicial in nature.

The determination of "materiality" involves the exercise of judgement and discretion. The intention of the Panel was to provide a means of limiting appeals activity, so as to reflect the costs that the appeals process imposes. It was intended that this be left to the discretion of the review body. However, in maintaining the Tribunal as the review body, the threshold requirements would be specified in the NEL and NGL. This would:

- avoid the situation where the Tribunal can modify its own powers to hear particular matters;
- ensure clear separation between policy decisions and individual adjudicative decisions; and
- ensure that policy decisions affecting individual rights are made in a way which ensures accountability.

As with the status quo, the Tribunal would only have access to the information that was before the decision maker at the time of its decision until the ground for review had been established. Following the establishment of the ground for review, the Tribunal could seek additional information from the nominated interested parties, subject to that information not being unreasonably withheld from the primary decision maker at the time of the decision, where this information has direct implications for the issue under consideration. In this process, the primary decision maker would be required to provide a record of its processes in making its initial decision as the starting point for the Tribunal's determination of what is the preferable decision. In addition, the primary decision maker would be required to provide advice to the Tribunal about other aspects of the original decision that may have bearing on the Tribunal conclusions about the preferable decision.

In keeping with the status quo, when making its decision, the Tribunal would be able to remit the decision back to the primary decision maker or substitute a preferable decision. Where the Tribunal makes a preferable decision, this would replace the regulatory determination of the primary decision maker. Any decision made would also be open to appeal through judicial review in the Federal Court of Australia.

Under this option, the review is limited by the material the Tribunal can consider before a ground for review has been established, using the primary decision makers' documented process as the starting point (such that the Tribunal process is incremental to the original process) and the time required for the Tribunal to complete its processes. This would ensure that the review is limited and not *de novo*.

The reviewable decisions under this framework are as per Option 1.

- What impact would the move to a single "materially preferable decision" criterion have on the outcomes of the limited merits review regime? Specifically, to what extent would such a criterion be compatible with retaining the Tribunal as the Review Body and what limitations might apply to the Tribunal in administering such a criterion?
- Are there any barriers to the Tribunal effectively performing its role in a purely administrative manner? What impacts would a move to a more administrative, less judicial approach have on the review process including the extent to which it would reduce or remove the need for participants to engage legal counsel?
- What, if any, restriction should be applied to the information the Tribunal can consider after the ground for review has been established? Are there any benefits associated with allowing the Tribunal to consider information that the regulator could not have reasonably considered in its initial decision making process.

Option 3: Amendments to the merits review framework and a new merits review body

This option is a full implementation of the Panel's recommendations; entailing the substantial change to the revisions to the framework outlined in Option 2, with differences, which are spelled out below, relating to the establishment of a new limited merits review body (the Review Body).

This option entails introduction of the framework changes outlined in Option 2, namely:

- Appeals should only be allowed or upheld if the Review Body is convinced that there exists a materially preferable decision.
- There is only to be a single ground for appeal: there are reasons for believing a relevant decision may be defective in that a materially preferable decision may exist and the primary regulator's decision does not promote economic efficiency in ways that best serve the long term interests of consumers.
- The Review Body will assess whether a materially preferable overall decision is available with specific reference to the NEO and NGO; that is, specific issues or errors raised by the appellant may be considered in the context of the impact on the overall decision.
- Applications for review should be open to regulated network businesses, energy ministers, consumer and user representatives, and other parties with a sufficiently material interest in the decision.
- The same body should handle the review of all decisions where the AER is the primary decision maker.
- 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.
- Time limits on hearing of appeals should be retained but extended from 3 to 6 months.

In addition to these changes, this option will include the implementation of the Panel's recommendations as follows:

- It would be left to the Review Body to determine the materiality threshold in practice as this could vary significantly between appeals.

- The Review Body would adopt an investigative approach to reviews of the relevant decisions, with interested party's views, including those of consumers, being routinely sought throughout the process.
- In performing this role, the Review Body would be subject to specific duties, including:
  - adopting the 'record' of the primary decision maker as the starting point for its own review;
  - supplementing the record with evidence from its own investigations;
  - inviting all interested parties to give views;
  - assessing whether there is a materially preferable decision and, if there is, substituting that decision or remitting the issue back to the primary regulator for further consideration; and
  - making decisions on the allocation of costs of reviews.

The Review Body would also be required to publish guidelines on its procedures, which would assist interested parties in initiating or engaging in a review, particularly in the first years of the new arrangements. The guidelines would cover, among other things:

- 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; and
- when public hearings might be held.

In addition, the guidelines would provide details around how the scope of its investigations are limited, including engagement, presentations, formats for submissions, treatment of vexatious issues and timelines.

It would be up to the Review Body to determine the materiality threshold in practice, depending on the issue being considered. One advantage of using the "materiality" threshold, rather than a fixed threshold, is that materiality can be used to establish a degree of proportionality between the likely costs and benefits of review. The same threshold would apply for appeals regardless of which party brings the appeal.

In addition to the framework changes, this option entails the establishment of a new review body.

- The appeals functions of the Tribunal would be transferred to a new Review Body that is fully administrative in character (i.e. is not judicial in nature).
- The Review Body comprise a standing panel of potential reviewers, of whom five would be chosen to consider individual cases.
- The members of the Review Body would be chosen on the basis of proven expertise, such as regulatory, energy market and other relevant backgrounds including commerce and business, government policy, economic regulation, finance and accounting, engineering, and legal.
- The Review Body would be supported by a small support team with relevant expertise residing within an existing relevant organisation, members of which may participate on a temporary or intermittent basis.

- The Review Body would be an independent panel 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.
- The host agency for the Review Body would be the AEMC.
- The Review Body Chair and panel members would be appointed according to established criteria, and the panels selected for individual reviews by the Review Body Chair.
- The Review Body could draw the support team from the AEMC, and engage consultants when deemed necessary.
- The overhead costs of the Review Body would be shared among network service providers in proportion to their annual revenues, of which 50 per cent would be allowed as a recoverable cost in revenue determinations, unless otherwise determined by the Review Body. The direct costs of the review panel in individual cases would be borne in the first instance by network service providers, 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 would bear their own, private costs.

Further details proposed by the Panel about how this could work in practice are at *Appendix VI*.

Similarly to Option 2, a review could be lodged on the basis that the appellant has reasonable evidence that there is a more correct or preferable underlying component or components to the regulatory determination (or 'decision') that could lead to a more preferable overall decision that is in the long term interests of consumers. This approach does not limit the potential for interested parties to raise points that could be raised under status quo, such as the need to correct an error, for non-discretionary matters; it still allows 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. However, in raising these points the interested party must demonstrate that a materially preferable overall decision exists.

As with the options 1 and 2, it would be for the Review Body to determine whether a ground for review has been established, that is, a materially preferable overall decision may exist. However, consistent with Option 2, in making its decisions around both the ground for review and what a materially preferable decision would be, the Review Body would be required to seek input from the primary decision maker as its starting point. In addition, the Review Body is able to seek input from other participants in the review, including the relevant network service provider, a Minister of a participating jurisdiction, and a user, consumer or a person or body who is a reviewable regulatory process participant where it has established there is a sufficiently material interest, where they have nominated an interest in participating in the review process (referred to as 'interested parties'). It would be at the discretion of the Review Body as to how it would conduct the review, but it would be required to be administrative and not judicial in nature.

In keeping with options 1 and 2, the Review Body would only have access to the information that was before the decision maker at the time of its determination until a ground for review had been established. Following the establishment of a ground for review, the Review Body will seek additional information from the nominated interested parties, subject to that information not being unreasonably withheld from the primary decision maker at the time of the regulatory determination.

For Option 3, the areas the Review Body would have the ability to look into are unlimited, in that it would be able to consider issues beyond the matter being appealed. However, the Review Body would be required to use the primary decision maker's process as a starting point (such that the Review Body process is incremental to the original process). The information the Review Body could request would also not be limited by the issues raised by the appellant. However, the review would not be de novo as the Review Body would not remake the decision from scratch and would be required to make its decision within a legislated timeline. The Review Body would also need to justify its decisions on the basis of it being a materially preferable decision in the long term interests of consumers.

In line with options 1 and 2, when making its decision, the Review Body would be able to remit the decision back to the primary decision maker or substitute a preferable decision. Where the Review Body makes a preferable decision, this would replace the regulatory determination of the primary decision maker. In effect, this means, even if constituted under state legislation, the Review Body's decisions would be open to appeal through judicial review in the Federal Court of Australia.

The difference in approach between options 2 and 3 relates mainly to the scope of the reviewing body to go beyond the specific matter being appealed. Under Option 3, the Panel considered that the process would be more akin to an audit, where the Review Body would have the capacity to look at how the entire determination fits together, in the context of whether it serves the long term interests of consumers. In contrast, in Option 2 the Tribunal would continue to operate in accordance with all the different types of legislation it is bound by and, therefore, would be more limited in only focusing on the specific matter being appealed and may only seek information about other factors that have a bearing on whether revising the matter being appealed would lead to a more preferable decision overall.

Under Option 3, the review is limited by the material the Review Body can consider before a ground for review has been established, using the primary decision makers' documented process as the starting point and the time required for the Review Body to complete its processes.

The reviewable decisions by the Review Body under this option are:

- AER[28] decisions to draft and approve or revise gas access arrangements;
- AER ring fencing decisions, including non-approval or voiding of associate contracts, in gas;
- AER pricing and revenue determinations for transmission and distribution in electricity (including application of regulatory test); and
- AER decisions not to exempt entities from ring fencing guidelines or impose additional ring fencing requirements, in electricity[29].

Ministerial and NCC decisions are not listed above as, given the proposed changes to the Review Body, the Panel recommended it would be more suitable for these decisions to be dealt with under review arrangements that exist for Ministerial declaration decisions more generally under the Part IIIA access framework of the *Competition and Consumer Act 2010*.

[28] In the case of Western Australia, the relevant decision-maker is the Economic Regulation Authority (ERA).
[29] In the Northern Territory and Western Australia the model applies to gas access matters.

- Are there specific benefits and risks associated with the Panel's model for the Review Body? Do stakeholders have any views on how the model could be modified to address these risks? This might include, but not limited to, the restrictions around information or process. How might those modifications affect the effectiveness of the investigative process?
- What level of prescription around the establishment and operation of the Review Body do stakeholders consider necessary? Specifically, how would introducing a requirement for a judicial member, whether current or retired, to the Review Body (be it as a Deputy Chair or standing member) ameliorate concerns that the Review Body would not give due consideration to the legal issues? Is there a risk that this may create a pseudo Tribunal?

Impact Analysis

Framework for analysis

Consistent with COAG's best practice regulation guideline, for each option this RIS will identify the groups in the community likely to be affected and assess the relevant benefits and costs. In analysing each option, this RIS will assess the impact on those issues identified in the Statement of Problem, and whether the identified objectives can be achieved.

Given that regulatory decisions in relation to electricity in Western Australia and the Northern Territory are not subject to merits review under the NEL, the proposed changes outlined in options 2 and 3 will not impact on electricity consumers or providers in Western Australia or the Northern Territory. Options 2 and 3 do not differentiate between the NEM states and territory, and so the impact on each of those jurisdictions is not expected to be different and will depend on the specifics of future reviews.

The same regulatory framework, including the limited merits review regime, applies to all three domestic gas markets. There is no reason to expect that different states or territories will be affected in different ways by options 2 or 3.

The stakeholder positions presented below are based on the preliminary feedback to the Expert Panel's Stage Two Report, as received by the SCER Secretariat in early October 2012. The comments are provided here for general information, but without prejudice to feedback from those sources to the questions raised in this consultation document.

In preparing submissions, stakeholders should bear in mind that the changes to the energy markets regulatory framework outlined in 'related changes to energy markets' will be in place regardless of which option is chosen.

In making submissions, stakeholders are requested to provide details, preferably supported by quantitative evidence, about the costs and benefits associated with each option to inform the development of the SCER's policy position. Subject to confidentiality considerations, the SCER will publish how this evidence was used to inform the development of the final policy position as part of the decision RIS.

Stakeholders should focus on providing evidence of the potential impacts of the options under consideration. Given the extensive consultation already undertaken by the Panel, stakeholders should focus on providing evidence and new information to assist SCER in its deliberations.

In addition, noting the complex interactions between the electricity and gas objectives, the pricing and revenue principles and the objective for the appeal regime, SCO seeks input on the short and long term implications of each option for different stakeholders. Consequently, SCO requests that submissions provide information on short and long term outcomes and a relative weighting to provide an indication of significance.

Option 1

Benefits

Key benefits of the current limited merits review include:

- identification and rectification of regulator error and ensuring accountability of the regulator;
- it is understood by all stakeholders in the energy market;
- the Tribunal's reviews to date have established a body of precedent and an understanding of the way in which it operates; and
- it is consistent with other access regimes established under the *Competition and Consumer Act 2010*.

The current limited merits review regime is understood by all stakeholders in the energy market, and the Tribunal's reviews to date have established a body of precedent and an understanding of the way in which it operates. In addition, the review regime is consistent with other access regimes established under the *Competition and Consumer Act 2010*.

Risks

Key risks associated with Option 1 include:

- loss of confidence in the limited merits review regime and continued disengagement of consumers from the appeals process;
- promoting appeal activity as a routine part of the economic regulation process;
- compromising the legitimacy of the overall regulatory framework in the longer term; and
- the operation of the limited merits review regime is not establishing that the resultant decisions are in the long term interests of consumers.

The Panel (supported by a number of submissions) identified a range of problems associated with the current limited merits review regime (as listed in the 'background' and 'problem' sections of this RIS). There is the potential for the issues identified by the Panel to get worse, should the regime remain unchanged, particularly those associated with the inability for consumers to engage in the review process, as this excludes the parties on whose behalf these regulatory decisions are made from providing feedback during the review process. Over time, these concerns could compromise the legitimacy of the overall regulatory framework.

Critically, the Expert Panel was concerned that the operation of the limited merits review regime was not in the long term interests of consumers.

While the AEMC has made amendments to the economic regulation of network businesses, these rule changes are intended to improve the regulation applying to network businesses and will not affect the operation of the limited merits review regime. Importantly, the amendments will not address the weaknesses identified by the Panel.

Stakeholder positions

Initial feedback provided to the SCER Secretariat on the Panel's Final Report indicates Option 1 is generally not recognised by any stakeholders as an appropriate framework. However, based on the information in their submissions, the following organisations supported only minor changes to the existing limited merits review regime:

- Australian Pipeline Industry Association (APIA);
- ATCO Gas;
- Financial Investor Group (FIG);
- Energy Supply Association of Australia (ESAA); and
- United Energy and Multinet Gas.

Generally, stakeholders supported minor amendments to the existing regime because:

- change would place too much emphasis on the short term interests of consumers rather than their long term interests;
- the current focus on error correction is appropriate, and that in any case the Panel did not demonstrate that a move away from error correction would better serve the long term interests of consumers;
- existing grounds of appeal are well understood;
- change will render irrelevant the established body of regulatory and Tribunal precedent, which will increase regulatory uncertainty, cost and risk;
- the view that the current process promotes investor confidence and certainty;
- there are significant implementation risks associated with change;
- investments in energy infrastructure are recovered over many decades, making a stable regulatory regime vital to investor confidence;
- the proposed process is effectively a 'de novo' review; and
- attaching the new body to the AEMC would cause a conflict given the relationship between rule maker and judge.

More detail on the views of these organisations is provided at *Appendix III*.

Impacts on stakeholders

This option will not introduce any new impacts on stakeholders. However, it will not address the current barriers to consumer participation in the review process.

Option 2

Benefits

The key benefits of Option 2 include:

- a focus on whether there is a materially preferable decision, thereby better achieving the objectives of the NEL and NGL and ensuring the decision is in the long term interests of consumers;
- introduction of disincentives to appeal with a view to reducing routine appeals of regulatory determinations;

- still allows 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;
- saving costs for those participating in a review, particularly reducing the need for legal costs;
- better consistency with the MCE's original policy intention;
- enhancing accountability by providing the regulator with a stronger incentive to make a correct initial decision and apply the relevant laws consistently;
- the approach adopted by the Tribunal will better equip the regulator in its initial decision-making process and stakeholders for the review process;
- enhancing longer term regulatory certainty and generating greater confidence in the overall regulatory framework;
- improving consumer and user group participation in the process; and
- reducing the risk of future 'gaming' of the review process.

Option 2 would focus the Tribunal on whether there exists a materially preferable decision. The Panel was not convinced that the existing regime was resulting in preferable decisions. With a focus on materially preferable decisions, better final decisions should be made, which would better achieve the objectives of the NEL and NGL and be in the long term interests of consumers and the economy.

The Panel concluded that a focus on materially preferable decisions would reduce appeal activity. The Panel noted that a change to a more administrative and less judicial approach would also speed up the decision-making process and save costs for those participating in a review, particularly removing the need for legal costs.

Option 2 will also move the Tribunal away from its current practice, which the Panel found to be very close to a process of judicial review, and towards a genuine limited merits review regime, which is more consistent with the original, and recently confirmed, intention of the MCE.

A more effective review regime should enhance accountability by providing a stronger incentive to the regulator to ensure that the initial decision is correct and that the relevant laws are consistently applied. Other changes to the energy markets regulatory framework should also improve decision-making by the regulator.

Over the longer term, as the Tribunal makes decisions under the revised review framework, examples of how the Tribunal performs its refined role and how it engages with consumers will be demonstrated over time. With a focus on materially preferable decisions, this information would better equip the regulator in making its decisions and determination participants with more insight into how to engage effectively in regulatory processes.

With better decisions from the regulator and the Tribunal, over time there should be a reduction in the number of appeals, with less appeals being successful. These outcomes would help to address the regulatory failures identified in this RIS, enhancing regulatory certainty and generating greater confidence in the overall regulatory framework.

If the Tribunal adopts a less legalistic approach to reviews, there will be less of a barrier to participation in the process by consumers and user groups. Combined with other measures being adopted through SCER to provide consumers with a greater voice in the energy markets regulatory framework, the Tribunal could better balance the competing interests involved in reviewing a determination, and address the lack of attention to the requirements of consumers identified by the Panel as a general weakness of current regulatory

arrangements. Better processes to allow the voices of consumer and other stakeholders to be heard is consistent with the objective of the review regime and will add to the legitimacy of the review process and, more broadly, the regulatory framework.

The focus on whether a materially preferable decision exists, rather than on correcting an error associated with a particular aspect of a decision, means that appellants have less influence, at the beginning of the appeal stage, on the way that matters are subsequently examined, which should reduce 'gaming' risks.

Risks

The key risks associated with Option 2 include:

- ongoing tension in a tribunal-based system for court like, quasi-judicial processes;
- concerns around the Tribunal being able to make decisions that reference the long term interests of consumers as set out in the NEO and NGO;
- merits review of the form developed by Australian tribunals may not be suited to regulatory determinations, which involve extensive inquiry and decisions affecting multiple interest groups with high policy content;
- the Tribunal may be limited in its ability to 'stand in the shoes' of the primary regulator;
- the Tribunal may have difficulties in recruiting and retaining suitably qualified staff to work on comprehensive reviews;
- uncertainty regarding how existing precedent of the Tribunal will be applied in the new framework;
- over the short term there would be a period of uncertainty as the Tribunal adjusted to its revised method of operation; and
- over the long term, if the Tribunal was not able to operate in an administrative manner, there is a serious risk that many of the benefits outlined above would not be realised.

Option 2 requires the Tribunal to be administrative rather than adversarial or judicial in nature. The Panel was concerned that the prospects of achieving this objective would be uncertain, if not poor, because of the tension in a tribunal based system between pressures for court like, quasi-judicial processes and pressures for tribunals to be more investigative and inquisitorial, speedy, informal and low cost.

The Panel noted that tribunals in Australia have struggled to operate in an 'inquisitorial manner', instead adopting traditional judicial operating approaches. The Panel drew the inference from its look at Australian merits review tribunals that their operation is subject to a number of persistent influences which would be difficult to change.

The Panel also noted concerns with the Tribunal being able to provide make decisions that reference the long term interests of consumers as set out in the NEO and NGO. In particular, there are questions about whether the Tribunal is able to establish and explain how its decisions are in the long term interests of consumers.

The Panel was also concerned that some features of the energy markets regulatory framework and the culture of the Tribunal itself would represent significant obstacles before the Tribunal could effectively carry out investigative tasks. Reasons advanced by the Panel included:

- merits review of the form developed by Australian tribunals may not be suited to revenue/price determinations, which involve extensive inquiry and decisions affecting multiple interest groups with high policy content;

- the Tribunal is limited in its ability to 'stand in the shoes' of the primary regulator; and
- the Tribunal may have difficulties in recruiting and retaining suitably qualified staff to work on comprehensive reviews.

In a submission on the Final Report, the AER and the Australian Competition and Consumer Commission (ACCC) presented a view that the Tribunal could be made more administrative in nature by publishing a practice note outlining its processes, not holding hearings or discussions in a court room and only involving legal advisors in resolving questions of law. In addition, ENA opposed changes to the Tribunal on the basis that the Tribunal "is a respected review body with a proven track record of delivering robust and transparent decisions".

If this option were implemented, over the short term there would be a period of uncertainty as the Tribunal adjusted to its revised method of operation, and as a new body of precedent developed. Litigants and market participants would require time to develop confidence in the revised operations of the Tribunal.

Over the long term, if the Tribunal was not able to operate in an administrative manner, there is a serious risk that many of the benefits outlined above would not be realised. There are a range of different views as to whether this is feasible, noting that this would not be driven by legal limitations, rather cultural or practical barriers. This has the potential to affect the feasibility of any approach bar reform to the review body; given this could be a fundamental impediment to delivering the policy intent. Consequently, SCO is seeking advice about limitations, whether cultural or practical, that may limit the effectiveness of framework changes alone to address the issues the Panel identified with the performance of the regime to date.

Impacts on stakeholders

The intention of Option 2 is to focus the Tribunal on the long term interests of consumers. As noted in the Statement of Problem, consequently, the long term impact of the focus on the long term interests of consumers required by Option 2 should be to produce risk appropriate rates of return for network businesses.

Option 2 should produce little impact on electricity generators and gas producers. There will be little impact on energy retailers as any changes to costs would be passed on to end users.

Consumers would benefit from being able to initiate reviews, by having a stronger voice in reviews and by having reviews more focussed on their long term interests.

The need to establish that a materially preferable decision that serves the long term interests of consumers may increase costs for network businesses in lodging an appeal under this framework.

If these changes to the limited merits review regime result in less appeals, there will be cost savings to all parties to the process including the regulator and the Tribunal would be required to hear fewer cases in a given year.

Stakeholder positions

Based on initial feedback provided to the SCER Secretariat on the Panel's Final Report, Option 2 more closely reflects the general positions of the AER and ACCC and has some similar features to the positions presented by ENA and Jemena (noting that there are some significant differences as well).

Generally, these submissions indicated changes, such as those identified in Option 2, would be preferable because:

- the proposed amendments to the limited merits review framework would provide an opportunity for the decision to be reviewed holistically and would change the error focussed nature of the current regime;
- an inclusive and investigative approach to reviews will reduce barriers to consumer group participation; and
- the Tribunal would be retained as the review body.

More detail on the views of these organisations is provided at *Appendix III*.

Option 3

Benefits

The key benefits of Option 3 include:

- a focus on whether there is a materially preferable decision, thereby better achieving the objectives of the NEL and NGL and ensuring the decision is in the long term interests of consumers;
- still allows 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;
- the Review Body would be able to undertake an investigative approach;
- introduction of disincentives to appeal with a view to reducing routine appeals of regulatory determinations;
- more timely decision-making by speeding up the process through the provision of the regulators report as the starting point for review;
- saving costs for those participating in a review, particularly removing the need for legal costs;
- improving accountability;
- enhancing regulatory certainty and generating greater confidence in the overall regulatory framework;
- improving engagement in the process for consumers;
- ensure that decisions reflect the long term interests of consumers; and
- reducing the risk of future 'gaming' of the review process.

In proposing the transfer of review functions from the Tribunal to a new review body, the Panel focussed on an assessment of whether the Tribunal could effectively carry out the proposed investigative tasks, including the need to assess overall regulatory determinations.

The new Review Body would be able to undertake the proposed investigative approach in a way that the Panel envisaged. Further, the Review Body would be designed to operate in an administrative rather than adversarial or judicial manner.

This investigative approach was viewed by the Panel as being a key to unlocking the benefits of the various changes proposed by the Panel, and ensuring that the review body reaches decisions that are materially preferable and in the long term interests of consumers.

The Panel concluded that a focus on materially preferable decisions, accompanied by an investigative approach, would reduce appeal activity. The Panel noted that a change to a more administrative and less judicial approach would also speed up the decision-making

process and save costs for those participating in a review, particularly removing the need for legal costs.

The focus on whether a materially preferable decision exists, rather than on correcting an error associated with a particular aspect of a decision, means that appellants have less influence, at the beginning of the appeal stage, on the way that matters are subsequently examined, which should reduce 'gaming' risks.

Risks

The key risks associated with Option 3 include:

- uncertainty about how the Review Body would operate;
- jeopardising the ability of network service providers to secure finance for necessary investments; and
- compromising the independence of the Review Body if it does not have sufficient formal separation from the supporting organisation.

There are potential downsides to establishing a new review body, particularly in the short term. Initially, there would be uncertainty about how the Review Body would operate, this uncertainty would be exacerbated by the revision of the grounds for appeal. Over time, the review body would generate its own operational arrangements and confidence in its operations and legitimacy in its functions will increase if it performs its role effectively.

FIG was one stakeholder which considered that the proposed review body brings a significant degree of regulatory uncertainty and risk, thereby jeopardising securing financing for necessary investment. Given the other changes to the framework, this includes a great deal of uncertainty about how it would operate in practice.

The Panel recommended that the Review Body should be attached to an existing administrative organisation, principally for reasons of cost and staff recruitment. With the number and frequency of appeals uncertain and likely to be intermittent, attaching the Review Body to an existing agency would allow staff to be seconded to the Review Body on an as needed basis, minimising the number of staff working on an ongoing basis when there are no appeals before the Review Body.

The Panel recommended that the host agency for the Review Body should be the AEMC. The primary advantage of the AEMC was that it is an organisation dedicated to energy matters, and has staff with relevant knowledge and skills to assess revenue and price determinations.

The clear risk with allocating the host agency role to the AEMC is that there is the potential to compromise the independence of the Review Body. The Panel itself was of the view that significant separation of the AEMC and the Review Body is necessary and this is part of their detailed proposal (see *Appendix VI*).

There are cases where a Review Body is hosted by the associated decision making body, for example the Migration Review Tribunal and Refugee Review Tribunal being hosted by the Department of Immigration and Citizenship. In that example, the architecture of the Tribunals was designed to ensure the independence of the review from the decision-making body.

Costs

The Panel recommended that the Review Body should have access to an adequate budget for the performance of its function. In the first instance it should be funded by appropriate levies or charges on energy network businesses, part of which could be recoverable from

adjustments to the regulatory determinations. The Panel considered that these costs would be minimal due to the likely reduction in the number of appeals.

Consistent with normal practice, the Review Body should be accountable for its performance and use of funds, have its administered accounts audited, and should publish an annual report on its activities, performance and finances. There would be no costs to governments in establishing and operating the Review Body.

In terms of estimating costs associated with setting up the Review Body, in 2009, an amount of around $6.6 million was allocated to manage the setup of the Australian Energy Market Operator (AEMO). Noting this relates to a significantly larger organisation and complex process, this is being used as an indicative amount for how much it would cost to establish a new body. In reality, it would be likely to be significantly less than this.

While network businesses would be required to fund the costs associated with the Review Body, initially, these costs would, in part, flow through to consumers as higher network charges. However, over the longer term the costs for consumers would be offset by lower regulatory and legal costs due to a reduction in the number of reviews being conducted.

In terms of ongoing costs, Australian Government Tribunals have a range of annual costs that cannot readily be translated for the Review Body proposed by the Panel. However, to provide an indicative amount for the purposes of consultation, adjusting the costs of these Tribunals to reflect the 15 review panel members envisaged by the Panel, results in an estimated annual cost of $5.5 million. In making this calculation, it was recognised that the Review Body would have a significantly smaller case load (with the number of reviews over a five year period numbering in the tens at most, rather than the thousands the other Tribunals review in a year), although these reviews would be more complex and involve greater technical detail. It is likely that the annual cost, in reality would be much less than this amount.

The costs associated with the Review Body have the potential to increase the costs for operation of the associated support organisation, which the Panel envisaged would be the AEMC. The significance of this burden relates to the types of functions the support body would be required to provide to the Review Body. While the Panel expected that the Review Body itself would have technical expertise to perform the investigative role under this option, SCO recognises that there is the potential for the Review Body to seek additional technical and consultant support from or through the support organisation (see Box 3).

On balance, it is likely this approach would lead to fewer reviews, being conducted over a shorter total timeframe. This, coupled with removing the need for legal representation, would reduce the overall cost of appeals and reduce costs for those participating in a review. Although, to the extent that consumer groups and others are better able to participate in a review, they will incur costs from participation, but the proposed change in approach means the aim is to reduce the need for legal costs.

Box 3: Potential support agencies

The Panel recommended that the Review Body should be attached to an existing administrative organisation, rather than established as a stand-alone body, and recommended that the host agency be the AEMC due to skills and expertise in relevant energy issues and less conflict issues than other options. Whichever agency is chosen, it would have to provide general administrative assistance, secretariat support for the Review Body and, specific and technical assistance with reviews.

General Administration

General administrative assistance would include:

- human resources support, back office support (such as IT, website, property, security and records management);
- logistical support (such as travel, accommodation, per diems and arranging meetings);
- financial support (such as budgeting and financial management);
- communications (including publishing guidelines, reports and decisions); and
- secretariat support.

Being relatively general in nature, these tasks could be performed by a broad range of potential host agencies. While the Review Body will not be a large organisation or employ many people, the general administrative tasks will add a proportional workload to the host agency, which could have resource implications.

Technical Assistance

Providing specific assistance with reviews involves reviewing or summarising relevant documents and drafting documents for the Review Body. Technical assistance would include:

- supporting the investigative approach of the Review Body;
- assisting the Review Body in its investigation;
- analysis and developing advice for the Review Body;
- conducting analysis on relevant documents and information; and
- drafting technical material for the Review Body.

These tasks require technical skills, and could include practical knowledge around engineering, regulation, financial markets, modelling and legal issues.

The tasks involve providing both specific and technical assistance that is specialised; the Review Body would be best attached to an agency with relevant background and skills. Only a limited range of host agencies could provide these skills, including the AEMC, the ACCC or state-based regulators. Undertaking these tasks will have resource implications, including through contract management because many of the more specialised tasks are likely to involve contracting specialists or managing secondments.

Costs

The Panel envisaged that the overhead costs of the review body would be shared among network service providers, subject to the Review Body determining otherwise. To enable this to occur, the Review Body would enter into a contract for service to cover the costs of general administrative assistance. The Panel envisaged that the direct costs of the Review Body in individual cases should be borne in the first instance by network service providers, with the Review Body making a determination as to the percentage of its costs that are recoverable. These direct costs are secretariat support for specific reviews and specific and technical assistance with reviews.

Impacts on stakeholders

As both options 2 and 3 are directed at achieving the same outcome, the expected impacts on stakeholders are similar. The differences revolve around the risks involved in progressing options 2 and 3.

While Option 3 is *prima facie* a more uncertain approach, involving a new review body with new grounds of appeal and operating practices, there is a risk that Option 2 will not succeed because the Tribunal will be unable, in a practical and cultural sense, to operate in the required administrative manner. In that way, Option 3 represents more of a risk to investor certainty, while Option 2 is more of a risk to the long term interest of consumers.

The intention of Option 3 is to focus the Review Body on the long term interests of consumers. The need to establish that a materially preferable decision would serve the long term interests of consumers may increase costs for network businesses in lodging an appeal under this framework.

Option 3 should produce little impact on electricity generators and gas producers. There will be little impact on energy retailers as any changes to costs would be passed on to end users.

Consumers would benefit from being able to initiate reviews, by having a stronger voice in reviews and by reviews (and in turn regulatory outcomes) being more focussed on their long term interests.

If as concluded by the Panel, the changes to the limited merits review regime result in less appeal activity then there will be cost savings to all parties to the process, including regulators.

Stakeholder positions

Based on initial feedback provided to the SCER Secretariat on the Panel's Final Report, Option 3 is supported by the CALC, the Energy Users Association of Australia, the Independent Pricing and Regulatory Tribunal (IPART) and the Major Energy Users. However, even among these organisations, there was general concern about the proposed Review Body being part of the AEMC, which was viewed as involving an inherent conflict of interest. The AER and ACCC flagged that complex legal issues may be raised given that the AEMC is established under state legislation and there are questions about how this would apply to decisions made by a Commonwealth body.

In addition, IPART raised concerns about the potential for widening the review unduly unless the Review Body was limited to only that information available to the primary decision maker.

More detail on the views of these organisations is provided at *Appendix III*.

- What are the costs and benefits of each option for stakeholders? Do stakeholders agree with the risk and benefit analysis? Do stakeholders agree that the allocation of costs is appropriate? Do stakeholders consider that overall costs of options 2 and 3 may be lower due to less reviews being conducted and in a less legalistic manner?
- In assessing the overall costs of options 2 and 3, how might these be lower or higher that Option 1? For example, what impact would reducing the number of reviews or the changes from a legalistic approach have on costs?
- How could currently covered Ministerial and NCC decisions be treated under each of the options? Would it be appropriate for such decisions to only be reviewable through judicial review?

Consultation

The Panel undertook extensive public consultation in its review of the Limited Merits Regime. It released two consultation papers (on 30 March 2012 and 27 April 2012), and a discussion paper on 23 July 2012.

The Panel also released interim and final stage reports (Stages 1 and 2), and conducted two public forums (on 9 May 2012 and 30 July 2012). These forums were well attended by key stakeholders.

Following the release of the Final Stage Two Report, SCER consulted on its recommendations, and received 14 submissions. A summary of the views received from stakeholders is at Appendix III.

This consultation RIS is released for a period of seven weeks, and will submissions can be made up until 8 February 2013. The consultation RIS is available on the SCER and OBPR websites. The contents of this consultation RIS were agreed by SCO prior to its release. Interested stakeholders are encouraged to answer the specific questions listed throughout this consultation RIS.

Submissions may be made to the SCER Secretariat (see SCER website for details: www.scer.gov.au).

Stakeholders are requested to provide a breakdown of the costs of the options, including operational costs, financing costs and disputation costs. As necessary, this could be in a separate, confidential document. SCO will aggregate any information on costs to gain an industry-wide perspective and the data will not be able to be attributed to any one entity.

Evaluation and conclusion

Subject to further consultation, including through this RIS, SCO favours Option 3, entailing changes to the limited merits review framework and establishing a new review body. However, in developing the final policy position, SCO may consider possible variations to the Panel's specific recommendations including relating to details around how the Review Body would function in practice, informed by this consultation and comparison with other review bodies.

Both Options 2 and 3 will focus the Review Body on whether the decision was justified in terms of the NEO or NGO, and on whether there exists a materially preferable decision. This shift in focus is intended to reduce appeal activity (by providing disincentives to appeal) and generate better decisions by both the primary decision maker and the Review Body.

The changes to the limited merits review regime involved in Option 2 will go partway to addressing the issues identified by the Panel, but SCO notes the Panel's advice that the key to unlocking the benefits of change involves shifting the focus of the appointed Review Body away from operating in a judicial manner. Under Option 3, a dedicated Review Body without formal judicial representation will be established to operate in an administrative manner, which is more suitable for reviews of decisions that involve the exercise of significant discretionary powers. The review would be intended to be an exercise in seeking to discover whether there exists a materially preferable decision, as opposed to a contest between interest groups.

Adopting a less judicial approach to reviews means there should be less of a barrier to participation in reviews by consumers and user groups, which should assist the reviewer to better balance the competing interests involved in reviewing a determination.

Implementation and review

The next round of regulatory determinations are scheduled to commence in 2014 and any amendments to the limited merits review regime should be finalised well in advance of those determinations being finalised. To help achieve this, it is proposed to finalise the decision RIS by March 2013.

In relation to determining the effectiveness of the reform, the SCER will continue to monitor the review process and outcomes to ensure that objectives for the regime are being met.

Appendix I – Australia's energy markets

Market reform

Reliable and competitively priced energy is essential for the productivity and competitiveness of the Australian economy. It is therefore unsurprising that reviews by the Industry Commission and the Independent Committee of Inquiry into a National Competition Policy for Australia (the Hilmer Inquiry) in the early 1990s identified the significant benefits that were potentially available from introducing competitive market arrangements for the trading of electricity and enabling free and fair trade of natural gas. These findings led to the Council of Australian Governments (COAG) committing to the implementation of reforms to the electricity and natural gas industries under the National Competition Policy and the related Competition Principles Agreement.

This energy market reform agenda targeted improvements to the efficiency of production, transportation and use of energy, through the establishment of competitive energy markets. Australia's energy markets were designed to provide incentives to drive more efficient operation of energy systems, and improve investment decisions in terms of timing, sizing, siting and choice of technology. The ultimate focus of these reforms was explicitly to deliver real economic benefits to consumers, through increased economic growth and improvements to the delivery of energy.

Australia's energy markets have undergone significant reform over the past 20 years, in particular the establishment of the National Electricity Market (NEM), national laws and institutions. This included the creation of national frameworks for regulatory governance, network regulation, planning, pricing, demand side participation and non-economic regulation. There is a close relationship between electricity and gas markets through a common legislative and policy framework established in accordance with the Australian Energy Market Agreement (AEMA). The AEMA sets out the high level reforms to the electricity and gas markets and was first introduced, by signature of first ministers, in 2004.

In 2001, COAG established the Ministerial Council on Energy (MCE) to implement its national energy policy framework as set out in the AEMA. The COAG Standing Council on Energy and Resources (SCER), established in September 2011, has replaced the former COAG MCE and Ministerial Council on Mineral and Petroleum Resources. SCER is responsible for ensuring the policy development for the nation's mineral and energy resources and markets to optimise long-term benefits to the community.

Governance

Australia's energy markets, excluding Western Australia[30], are overseen by three institutions: the Australian Energy Market Commission (AEMC), the Australian Energy Regulator (AER) and the Australian Energy Market Operator (AEMO).

The AEMC is responsible for rule making and market development in the national electricity and gas markets including, reviewing the energy market framework and providing advice to the SCER.

The AER is the principle regulator and enforcement body for energy in Australia. The AER is responsible for regulating the wholesale electricity market and for the economic regulation of the electricity transmission and distribution networks in the NEM (i.e. it is the primary decision maker for these decisions). It is also responsible for the economic regulation of

[30] With the exception of changes to the NGR made by the AEMC which relate to third party access to gas pipelines, which do apply to Western Australia.

covered gas transmission and distribution networks and enforcing the NGL and NGR in all jurisdictions except Western Australia.

The AEMO is responsible for the day-to-day operation and administration of the electricity and gas wholesale and retail markets in all jurisdictions except Western Australia and the Northern Territory.

The Northern Territory has its own bodies responsible for electricity market operation and regulation: the Power and Water Corporation and the Utilities Commission, respectively. However, the AER is responsible for the economic regulation of covered gas transmission and distribution networks and enforcing the NGL in the Northern Territory.

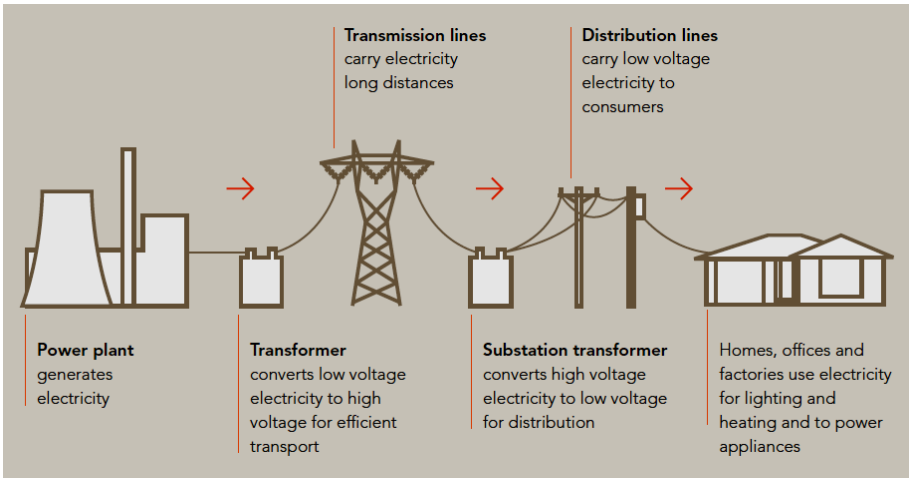
In Western Australia, the Independent Market Operator is responsible for electricity market operation and settlement, while the Economic Regulation Authority (ERA) is responsible for regulating Western Australia's electricity networks and the Dampier to Bunbury, Goldfields and Kalgoorlie to Kambalda gas pipelines and the Mid-West and South-West gas distribution system (the ERA is the primary decision maker for these decisions).

Electricity markets

Electricity markets serve to deliver electricity from generators to consumers at the least cost. The electricity supply chain (refer to Figure 2) can be broken down into:

- the generation sector, where generators compete to be dispatched in the competitive spot market;
- electricity networks, where transmission networks carry electricity at high voltage over long distance and distribution networks carry low voltage electricity to consumers;
- the retail sector, where retailers purchase electricity in the wholesale market and on sell to consumers;
- energy users, whose needs the market is fundamentally intended to serve;
- the financial markets, which operate in parallel to the spot market; and
- governance and legislative arrangements that underpin the operation of the market and impose certain obligations on participants.

Figure 2: Electricity supply chain



There are two electricity markets that operate in Australia: the NEM and the Wholesale Electricity Market (WEM).

The NEM began operations in December 1998 and now operates in south eastern Australia, with long interconnected networks linking Queensland, New South Wales, the Australian Capital Territory, Victoria, South Australia and Tasmania. The NEM is regulated by the National Electricity Law (NEL) and National Electricity Rules (NER). The NEL is a Schedule to the *National Electricity Act (South Australia) 1996*. This law was enacted in the South Australian Parliament and applied to other participating jurisdictions through application legislation.

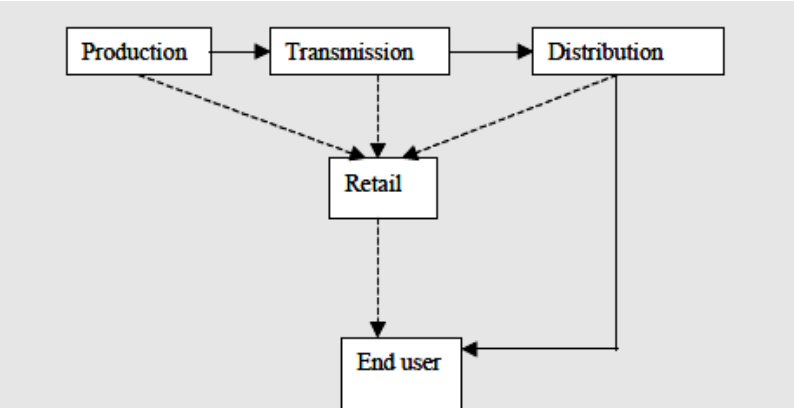
The WEM is the market that services the South West Interconnected System (SWIS) in Western Australia. The WEM is underpinned by state-specific legislation and does not apply the NEL or NER. Consequently, regulatory decisions in Western Australia are not subject to merits review under the NEL. Instead, prescribed administrative decisions may be appealed through the Western Australia-specific Electricity Review Board.

Gas markets

In Australia, the domestic gas supply chain consists of upstream gas production, transmission and distribution pipelines, and retailers. The gas supply chain (refer to Figure 3) can be broken down into:

- the upstream gas production sector, where businesses extract gas from a number of basins to be sold through the domestic or international markets;
- transmission pipelines to transport natural gas from production fields to demand centres;
- storage facilities to enhance security of supply by allowing for injections into the system at short notice to better manage peak demand and emergencies;
- distribution pipelines that typically consist of high and medium pressure (to transport gas between load centres in a distribution area) and low pressure (servicing end customers) pipelines; and
- gas retailers who create a range of products by varying the terms on which it offers natural gas such as the firmness of supply and the time of delivery.

Figure 3: Gas supply chain



The Australian domestic gas market consists of three distinct regional markets: the Eastern market (comprising Queensland, New South Wales, Australian Capital Territory, Victoria, South Australia and Tasmania); the Western market (Western Australia); and the Northern market (Northern Territory). Due to the vast distances between each region, the construction of pipeline infrastructure to connect these markets is uneconomic, at this time.

The NGL and NGR set out the regulatory framework for covered gas pipelines in Australia. A national access regime was established for pipeline access and regulation in 1997.

The NGL and NGR brought natural gas pipeline regulation under the national energy market institutions. The AER is the economic regulator of gas access arrangements in all jurisdictions except for Western Australia where the ERA determines access arrangements for transmission and distribution pipelines.

Appendix II – Expert Panel Review of the Limited Merits Review Regime

Milestone	Date
Expert Panel established	22 March 2012
Preliminary Consultation Paper	30 March 2012
Consultation Paper Two	27 April 2012
Ongoing consultation	
Interim Stage One report released	30 April 2012
First round consultation – public forum:	9 May 2012 (Sydney)
Final Stage One Report	30 June 2012
Stage Two Discussion Paper	23 July 2012
Second round consultation – public forum:	30 July 2012 (Sydney)
Ongoing consultation	
Interim Stage Two Report	31 August 2012
Final Stage Two Report	9 October 2012

The Panel's documents and the submissions it received can be obtained from SCER's website: www.scer.gov.au.

Appendix III – Preliminary stakeholder positions on the Expert Panel's Final Report

These positions are extracted from submissions provides to SCER in response to a request for feedback on the Panel's final report on 9 October 2012. The below should not be seen as prejudicial to the stakeholders final positions.

Stakeholder	Position
Australian Energy Regulator and the Australian Competition and Consumer Commission	1. The Expert Panel has properly characterised the problems with the limited merits review, which can be addressed by: a. a single ground for review of establishing a materially preferable decision exists; b. establishing appropriate limitations, including that there be no new material before the review body; c. maintaining the role of the ACT as the review body; d. establishing a well-funded consumer advocate. 2. The single ground for review has three benefits: a. there would be an upside and downside risk for all parties concerned; b. it would provide opportunity for the determination to be reviewed holistically; and c. it would remove the error-focused character of the current regime. 3. While the AER supports the Expert Panel's recommendations that there should be materiality thresholds and time limits, the review should be administrative in nature and limited to material before the AER. 4. Replacing the ACT is unnecessary; requiring the ACT to undertake an administrative review is by far the simplest, most effective and streamlined. a. The proposed review body involves a real conflict of interest if situated in AEMC – reviewing a determination requires an independent application of the rules. b. There are complex legal questions around whether the review body would fall under the jurisdiction of the Federal Court or various state supreme courts. c. An investigative process does not sit well with the objective of limiting a review to only material before the regulator and may increase the risk of gaming the process. d. The ACT's reluctance to undertake a holistic review is a direct result of the limited merits review regime. 5. The Tribunal could be made more administrative through: a. publishing a practice note outlining its processes; b. the review should be conducted on papers and supplemented by oral hearings or round table discussions;

	c. oral hearings or round table discussions should not be heard in a court room; and d. legal advisers should only be involved in resolving questions of law. 6. A fundamental barrier to effective consumer involvement is the complexity of regulatory determinations; a well-resourced consumer advocate is vital to effective consumer involvement.
Australian Pipeline Industry Association	1. Does not support change to NGO/NEO and believes that proposed changes would diminish the NGO's primary objective to promote economic efficiency. a. Believe that change will place too much emphasis on consumers' short-term interests (e.g. price), rather than their long-term interests. b. Changes will make NGO/NEO inconsistent with Part IIIA of the National Access Regime of the *Competition and Consumer Act 2010* that promotes economic efficiency. 2. Rejects single ground for appeal and believes that existing grounds for appeal are well understood and appropriate. a. Believe that one ground for appeal will reduce transparency. b. Proposed change lacks clarity about how it is demonstrated that a materially better decision exists. c. The focus on error correction is appropriate. 3. Does not support wholesale change to existing institutional framework but does support appropriate refinements. 4. Supports energy consumers' and users' improved participation throughout the regulatory process, including the appeals process.
ATCO Gas	1. Does not support changes to NGO/NEO and believe that changes will place too much emphasis on consumers' short-term interests rather than their long-term interests. a. Believe that change will render irrelevant the established body of regulatory and Tribunal precedent that would increase regulatory uncertainty, cost and risk for stakeholders. 2. Does not support the replacement of the Tribunal with the proposed AEAA. a. Review by judge necessary to protect legal rights of investors. 3. Believe that, over time, new process would evolve into a full *de novo* review that would result in investors going through two regulatory processes with increased compliance and transaction costs.
Consumer Action Law Centre	1. Questions the need for a high level RIS given the extensive consultation undertaken by the Panel. 2. Strongly supports the Panel's recommendations on: a. a single ground for review as this will significantly alter the risks/ reward calculation for NSPs;

	b. a preferable decision will be one that ensures regulatory determinations serve the long term interests of consumers; c. the review body should adopt an inclusive and investigative approach as this will reduce barriers to consumer group participation; d. standing should be provided to a broad range of interests to initiate a review; and e. the establishment of a separate appeals body to undertake a review. 3. Does not support this body being placed within the AEMC as this may be a conflict between its role as the rule maker even with some form of separation in decision making. 4. Strongly supports the establishment of a national energy consumer advocacy body.
Energy Networks Association	1. The Panel has proposed radical changes to a regime identified as 'world best practice'. 2. The Panel has erred in specifically excluding the need for decisions to be correct, which removes a fundamental legal protection. 3. The review process is effectively a hybrid version of de novo review, which has no precedent in Australian administrative law. The proposed limiting factors will be ineffective to address the costs and delay implications, and need further consideration. 4. The Panel has given insufficient consideration to modifying the Tribunal, particularly as the Tribunal has a proven track record. 5. Due to key linkages between the amended NER and NGR, policy design around any revised appeal arrangements should place a priority on ensuring that strict regulatory accountability for the exercise of wider discretion is not eroded. 6. Supports the establishment of a revised set of nationally focused consumer arrangements including the development of a fully-funded national energy consumer body.
Economic Regulation Authority	1. Best practice policy formulation requires a robust analysis of a range of alternatives to arrive at a sound basis for change. Without this, ERA cautions that policy proposals that may appear attractive may be found at a later stage not to be effective due to a lack of rigour in problem definition and in the analysis of alternative approaches. 2. The ERA agrees that the regulatory framework would be strengthened by enshrining the long term interests of consumers in the NGR and revenue and pricing principles. 3. Does not support change to NGO/NEO if it results in moving away from a primacy relating to economic efficiency that best serves the long-term interests of consumers. 4. The Panel have not demonstrated that a move away from error correction would better serve the long term interests of consumers. 5. If the recommendations are implemented, the same issues around WACC are likely to continue to be raised. 6. Supports limited relaxation on the time constraint on the merits review process. 7. The establishment of a new review body represents a major regulatory risk as it appears relatively unfettered and unaccountable.

	8. Considers that there is evidence that supports continuation of the Tribunal with adjustments. 9. The ERA is concerned that attaching the new review body to the AEMC gives rise to an immediate issue of conflict given the relationship between rule maker and judge. 10. The recommendation around single ground for review is problematic, as no two bodies will see things in the same light, which could drive the review body towards finding a 'better' decision. 11. Risk that the review body could broaden the scope to become a *de novo* review, although time limitations could mitigate this to some extent. 12. The investigative approach does not provide for the same degree of precedent (in interpretation) that the current approach delivers.
Energy Supply Association of Australia	1. Believes that existing grounds for appeal are appropriate and reject single ground for appeal. 2. Supports continuation of the Tribunal and do not believe that a radical overhaul is necessary. a. Believe that issues with the existing regime can be addressed if the AER is able to bring other matters, in addition to those grounds specific to the appeal, to the Tribunal's attention. 3. Supports improved consumer participation in both AER and Tribunal processes.
Energy Users Association of Australia	1. EUAA generally agrees with most of the Panel's recommendations. 2. EUAA does not support the new review body being associated with the AEMC through shared staff and through some level of coordination. a. EUAA questions whether the only way to obtain high quality staff is through the AEMC. b. The AEMC is answerable to a 'college' of governments, which slows reform, results in decisions that represent the lowest common denominator, and delivered greater bureaucratic power and/ or reduced accountability. 3. EUAA proposes an alternative structure, with independent staff and more government involvement in the Panel membership.
Financial Investor Group	1. FIG does not support the suggested change to the NEO/ NGO. 2. FIG considers the aim of the limited merits review regime should be to achieve decisions that are both correct and preferable. 3. There is not a distinction to be made between correct or preferable decisions as articulated by the Panel; before one option can be preferred over others, all the options must firstly be assessed as being consistent with the Laws and Rules. 4. FIG rejects the removal of error correction and its replacement with finding a preferable decision in the ground for review; the single ground for review, as currently framed, is likely to reduce transparency and accountability for AER and ERA decisions. 5. The need to improve the decision making of the primary decision makers should be a central aim of the limited merits review regime.

	6. The Panel has recommended a form of *de novo* review, with a full reconsideration of the initial decision with the capacity for the review body to gather fresh evidence. 7. FIG acknowledges reviews have been unduly narrow as a result of the AER and ERA being unwilling to use their powers under the current legislation to raise issues related to the review commenced by applicants. 8. FIG supports a continuation of the Tribunal as the review body and a clarification of the ability of the AER, ERA and the Tribunal to raise and consider matters related to the review. 9. FIG considers the alternative, purely administrative body proposed by the Panel brings a significant degree of uncertainty and risk, including too much uncertainty as to how it would operate in practice. 10. FIG considers the loss of quasi-judicial procedures and the risks associated with a purely administrative body pose a material risk of FIG's members continuing confidence in ongoing investment.
Independent Pricing and Regulatory Tribunal	1. SCER should adopt in full the Panel's recommendations to change the regime, but the review body should not hear evidence that was not before the initial decision maker. 2. A decision should only be replaced when it better serves the NEO. a. Under the current framework, the Tribunal is unable to consider the merits of individual component decisions in the context of the entire determination. b. The Tribunal is unable to consider whether businesses will still face infrastructure investment from other aspects of the regulatory decision. c. Providing a single ground for review will require the appeal body to balance its decisions and limit the 'cherry picking' concerns with the current regime. 3. The review process should apply a less court-like approach to hearing an appeal to allow the review body to 'stand in the shoes' of the primary decision maker. a. Many of the 'errors' found by the Tribunal to date relate to differences of opinion on highly complex and contentious topics that require the use of discretion. b. Currently the Tribunal is making decisions without the benefit of hearing directly from all stakeholders who participated in the regulatory process. c. IPART supports the establishment of a new administrative body. 4. The appeal should be a 'desk top' review, relying only on the information available to the primary decision maker; no further information should be able to be introduced by parties.
Jemena	1. Believes that existing grounds for appeal are appropriate and reject single ground for appeal.

	2. Does not support wholesale change to existing regime and states that any change without a strong case being made would undermine investor confidence. a. Believes that Panel's recommendations would, in combination, result in reviews that are closer to *de novo* review than the current limited merits review regime. b. Supports incremental change based on clear empirical evidence of a problem. c. Believes that review body needs to be totally independent of the rule maker (AEMC) and the regulator (AER). d. Supports the Tribunal being able to take a more investigative and less adversarial approach. e. Supports enhancing the Tribunal's capacity by adding suitably qualified people to undertake reviews and possibly widening reviews. f. Supports relaxation of time constraints and reducing the length of submissions allowable. g. Supports publication of a Tribunal practice note to assist stakeholders with participation in review process. 3. Supports creation of a better-resourced representative consumer body.
Law Council of Australia	1. The recommendation for a new review body should not be considered in isolation from the substantive economic regulatory arrangements in the current framework but considered in conjunction with the reform of the economic regulator regime.
Major Energy Users Inc.	1. MEU strongly agrees with most of the Panel's recommendations. 2. MEU strongly disagrees with the Panel's recommendation to use the AEMC as the review body; the review body needs to be skilled in balancing regulatory issues and have the appropriately skilled resources necessary to undertake the work. The MEU considers that the ACCC could provide the basis for a review body as it has a degree of separation from the AER to carry out such a task.
United Energy & Multinet	1. Does not support change to NGO/NEO and believe that changes will be applied to favour consumers' short-term outcomes rather than their long-term outcomes. a. Believe that change will allow a range of undefined factors, rather than efficiency, being brought into the decision making process. 2. State that errors need to be corrected but note that this will not necessarily result in reaching a different decision on appeal. 3. Support retaining the Tribunal as the appeal body. a. Believe that proposed AAEA process is *de novo* review by another name. b. State that review by a judge is necessary to protect legal rights of investors. c. Believe that current process, the NEL and the NGL can be changed to broaden the review, make it more inquisitorial and include accessibility where needed.

	d. Suggest that AER be obliged to submit to Tribunal its assessment of any implications of the appeal grounds and proposed amendments to the initial AER decision in respect of related issues, the NEO, the NGO and revenue or price determination. e. Tribunal could then conduct its own investigations into: the grounds and issues put forward by the appellant; and the assessment provided by the AER. 4. Support creation of a fully-funded consumer advocate body.

Appendix IV – International Experience

The approaches to appeals in the electricity and gas markets show considerable diversity in terms of process and scope. In the United States there is a heavy emphasis on trying to achieve settlement between parties, with contested matters that are not settled heard in trial-like proceedings before an administrative law judge. In contrast, in the United Kingdom, appeals of price control decisions in the electricity and gas markets are considered by an independent, external public administrative body (the Competition Commission), which conducts its own de novo investigation and can potentially substitute its own decision for that of the regulator.

United States – administrative litigation model

The United States' administrative and review arrangements in general terms differ from Australia in some significant respects. First, there is an emphasis at the administrative level on negotiated settlements and all parties, including interveners, are encouraged to engage in settlement negotiations at an early stage. However, in circumstances where settlement cannot be reached, matters are referred for 'administrative litigation' which is conducted by an impartial administrative law judge, usually located within the regulatory agency.

After conducting a trial, and collecting evidence, the administrative law judge will issue an Initial Decision. The Initial Decision, which is typically only recommendatory, is then reviewed by the Commissioners, who, after hearing any further evidence, will then issue the final decision and order. This final decision can be appealed to the relevant Courts, but the grounds for appeal are circumscribed (i.e. it is not a full merits or *de novo* review at this later stage).[31]

United Kingdom – external investigation

In comparison with Australia, wider discretion is delegated in the United Kingdom framework in both the conduct of price control matters, and in the review of the decisions of the primary decision maker - the Gas and Electricity Markets Authority supported by the Office of Gas and Electricity Markets In very general terms, the United Kingdom system is one where Office of Gas and Electricity Markets undertakes a periodic price control review, and then Gas and Electricity Markets Authority makes a price control decision. To effect this price control decision, the regulator will seek a modification to the licence issued to the relevant company.

Until November 2011, if a company was not content with the price control decision, it could reject the proposed modification of its licence. In the event of rejection, Gas and Electricity Markets Authority had the option of adjusting the decision and trying again, or could refer the matter to the Competition Commission, an administrative agency of government, for review. Since the proposed price control is contained in a licence condition, referral of a dispute about that licence condition means that the Competition Commission takes into account any factor considered relevant to the determination of the price control.

This arrangement does not involve an appeal in the normal sense. Licensees can simply veto regulatory decisions, and, if they do, it is at the discretion of the regulator whether or not to take matters to the Competition Commission.

Since November 2011 the appeals arrangements have changed, in response to the third European Union energy package. The new arrangements are currently untested, although the main features of the arrangements include:

[31] Yarrow, Egan and Tamblyn; *Review of the Limited Merits Review Regime; Stage One Report*, 29 June 2012, pp 24-27.

- abolishment of the veto power of companies over changes to their own licences - Gas and Electricity Markets Authority can now directly enforce its own decisions;
- all licensees (whether network companies, generators or retailers) and consumer representative bodies can appeal decisions;
- the Competition Commission decides whether or not to consider an appeal on defined criteria;
- the Competition Commission is effectively at large to consider whatever it thinks relevant in assessing the licence modification being challenged;
- the Competition Commission can quash the decision or relevant portion of the decision and either remit it back to Office of Gas and Electricity Markets for reconsideration and determination, in accordance with any directions given by the Competition Commission, or substitute its own decision and give any directions to Office of Gas and Electricity Markets or any other party to the appeal; and
- the Competition Commission is expected to complete its process within a period of six months.

As noted above, the primary review body for price control decisions in the electricity and gas markets in the United Kingdom is the Competition Commission. The Competition Commission is an independent public body which conducts in-depth investigations into matters relating to competition issues as well as having certain functions in relation to the utility industries. The Competition Commission does not initiate its own investigations but matters are referred to it by other authorities and agencies, including the sectoral regulators in energy, water and sewerage, railways, and airports. Competition Commission inquiries are conducted by a specially formed panel, typically comprising three to five members, including a Chair.

The option of 'Judicial Review only' is not possible in the United Kingdom, since merits review is required by relevant European Union Directives.[32]

New Zealand – merits review

Under the new arrangements in New Zealand, the Commerce Commission (the Commission) must periodically determine the 'input methodologies' that it will use to regulate different services within the electricity and gas markets. These input methodologies include matters such as cost of capital, asset valuation, allocations of common costs and pricing methodology.

A merits appeal is available to the High Court against an input methodology determination. The appeal can be made by anyone who 'gave views' to the Commission under the determination process and has a 'significant interest' in the matter. The appeal is conducted by way of rehearing, with the Court limited to considering the material before the Commission when it made the determination. To succeed on appeal, the appellant has an onus of establishing to the court that its own proposed methodology will be 'materially better' in meeting the purposes of the relevant legislation. The Court may confirm, amend or revoke the methodology determination, or refer it back to the Commission with specific directions for amendment. An appeal against the decision of the High Court can be made to the Court of Appeal only on points of law.

[32] Yarrow, Egan and Tamblyn; *Review of the Limited Merits Review Regime; Stage One Report*, 29 June 2012, pp 27-30.

Although input methodology determinations can be subject to merits review, the decisions of the Commission which incorporate these methodologies – such as the price-quality paths that are set for certain energy businesses – can be appealed only on questions of law. Appeals for judicial review of Commission decisions can be made to the High Court in New Zealand. Appeals against High Court decisions go to the New Zealand Court of Appeal, followed by the Supreme Court of New Zealand.[33]

Germany – administrative court proceeding

In Germany, decisions of the federal regulator in the electricity and gas markets (the Bundesnetzagentur) are subject to review in the first instance by a panel within the special cartel division of the Higher Regional Court of Düsseldorf. The panel that hears the cases comprises three judges, and examines both the facts and legality of a decision. In particular, the Court may make ex officio inquiries regarding the facts, can assign participants to comment on points or evidence, and can engage expert witnesses in relation to technical and economic matters. Appeals from the decisions of the Higher Regional Court are on the basis of judicial review only to the Federal Court of Justice.[34]

Netherlands – arbitration and litigation

In the Netherlands, the appeals process of decisions of the Dutch Office of Energy Regulation (which, similar to the AER, operates as a Chamber within the National Competition Authority) is split into phases. In the first phase, contested decisions can be re-considered within the regulatory agency, by a separate team, often as a first step before the appeal is then made to an external review body. If the matter is still contested, an appeal can be made to a specialist section of the relevant Court, which is an administrative court with judges who specialise in matters relating to the regulated industries and competition law. [35]

Republic of Ireland – investigative appeals

In Ireland, certain regulatory decisions in the energy (around generation) and aviation sectors can be subject to review by an appeals panel, which is specifically constituted at that time to hear the specific appeal. Although to date no appeals panel has been established in the electricity and gas markets, the legislation provides that the panel shall be independent and have all the powers and duties of the regulator that are necessary to carry out its functions. This panel, which can 'stand in the shoes' of the primary regulator, is expected to reach decisions in six months. [36]

[33] Yarrow, Egan and Tamblyn; *Review of the Limited Merits Review Regime; Stage One Report*, 29 June 2012, pages 30 and 31.
[34] Yarrow, Egan and Tamblyn; *Review of the Limited Merits Review Regime; Stage One Report*, 29 June 2012, page 31.
[35] Yarrow, Egan and Tamblyn; *Review of the Limited Merits Review Regime; Stage One Report*, 29 June 2012, pages 31 and 32.
[36] Yarrow, Egan and Tamblyn; *Review of the Limited Merits Review Regime; Stage One Report*, 29 June 2012, page 32.

Appendix V – Other appeal frameworks in Australia

There is currently also considerable diversity in the appeal arrangements for the other regulated sectors at the Commonwealth level in Australia. More than 400 Commonwealth Acts provide for the merits review of administrative decisions (made under those acts) by the Administrative Appeals Tribunal. In exercising its jurisdiction, the Administrative Appeals Tribunal has the ability to affirm, vary or set aside the decision of the original decision-maker. Other Commonwealth legislation gives responsibility for merits review of administrative decisions to more specialised tribunals, such as the Australian Competition Tribunal (the Tribunal).

The Tribunal is empowered to review the arbitration decisions of the ACCC associated with the economy-wide Part IIIA third party access regime, such as decisions in the railway and airports sectors. The Tribunal's role in reviewing these decisions is to re-arbitrate the access dispute and, for the purpose of the review, the Tribunal has the same powers as the ACCC. The Tribunal can either affirm or vary the ACCC's determination. Participation in this review process is limited to those who were involved in the ACCC's determination, and other parties permitted to intervene by the Tribunal.

The arrangements for review of decisions under the telecommunications specific access regime are set out in Part XIC of the *Competition and Consumer Act 2010*. Since January 2011, the possibility of merits review of undertaking determinations by the ACCC is no longer available. This follows from more general changes to the access regime, and in particular the replacement of the negotiate-arbitrate approach to one where the ACCC now has the power to set up-front access prices and terms for declared telecommunications services for a period of between three and five years. In effect, the Tribunal no longer has a role in hearing reviews in relation to access in the telecommunications sector.[37]

[37] Yarrow, Egan and Tamblyn; *Review of the Limited Merits Review Regime; Stage One Report*, 29 June 2012, pages 22 and 23.

Appendix VI — Details on the Review Body as proposed by the Expert Panel

Functions of the Review Body

The Panel recommended that the main activity of the Review Body when a review is launched be investigatory and inquisitorial in nature and not an adversarial process. The Panel also recommended 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 recommended that the Review Body 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.
- 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 Review Body 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.

Guiding principles for establishment of the Review Body

General principles for establishment of the Review Body

The Review Body 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 was the Panel's view that the key criterion for the appointment of members to the Review Body would be relevant experience, since it will be necessary for the Review Body members 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 Review Body 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 Review Body.

In terms of processes and procedures, the Panel recommended that the Review Body 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 Review Body 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 Review Body 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 was the Panel's recommendation that the Review Body be headed by a part time Chair, supported by two part time deputy Chairs, to provide leadership, chairmanship and oversight of the Review Body's review and administrative functions.

The Review Body should have a support team, which undertakes 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, the Panel recommended that the Review Body 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 Review Body should be accountable for its performance and use of funds, have its administered accounts audited, and publish an annual report on its activities, performance and finances.

Finally, the Panel recommended that the Review Body'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 Review Body and the AEMC

The Panel recommended that the Review Body be attached to the AEMC, and this may raise the question about conflict of interest in the nature of relationship between the new Review Body and the AEMC.

The Panel recommended that the Review Body be fully independent of the AEMC in conducting its reviews and decisions; and that the Review Body should also be provided with its own budget and public interfaces such as logo, web page etc.

Although the Review Body's support team would be selected from the AEMC, the support team would not be subject to AEMC direction or guidance whilst in the performance of duties for the Review Body.

In terms of the support staff available to work on particular matters and other resource issues, the Panel recommended that the Review Body be able to second staff (including temporary staff) from the AEMC for the purposes 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 including by the limited merits review process, the Review Body Chair and Deputy Chairs should meet with AEMC Commissioners regularly (e.g. 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.

Review Body relationship with SCER

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

Review Body appointments process and cost recovery

Appointments to the Review Body and to panels for specific reviews

As discussed above, the panel members of the Review Body should be appointed on the basis of merit using an independent search and interview process.

It was the Panel's view that the Chair and Deputy Chairs should be recommended and appointed SCER protocols for appointment in energy market governance institutions and panels.

The panel members would be appointed by the Review Body Chair and Deputy Chairs in accordance with the Protocol.

For individual reviews, the Review Body Chair should determine the membership of the review panel having regard to the matter being reviewed and the experience, knowledge and availability of panel members.

Staffing support for individual Review Body 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 through the AEMC on behalf of the Review Body (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 Review Body on an actual cost recovery basis.

Budget funding and cost recovery

The Review Body should be given an adequate and separate budget for the performance of its functions and to pay for the costs incurred including remuneration of panel members, 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. The Panel recommends that the overhead costs of the review panel should be shared among network service providers in proportion to their annual revenues, of which 50 per cent should be allowed as a recoverable cost in revenue determinations unless otherwise determined by the Review Body. The direct costs of the review panel in individual cases should be borne in the first instance by network service providers, with the review panel 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.

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