

Major Energy Users Inc.

10th November 2005

Manager-Energy Market Reform Team
National Energy Market Branch
Department of Industry, Tourism and Resources
GPO Box 9839
CANBERRA ACT 2601

Dear Sir,

**Consultation on MCE Review of Decision-Making in the Gas and Electricity
Regulatory Frameworks.**

I attach the Major Energy Users Inc. submission.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Mark Gell', written in a cursive style.

Mark Gell
Chairman

Ministerial Council on Energy

Energy Market Reform Bulletin No. 49

Comments on The Discussion Paper on Decision-Making in the Gas and Electricity Regulatory Frameworks.

SUBMISSION FROM:-

The Major Energy Users (MEU) Inc.

Representing

**EMRF – The Energy Markets Reform Forum;
ECCSA – The Energy Consumers Coalition of South
Australia and EUCV – The Energy Users Coalition of
Victoria**

November 2005

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Contents

Executive Summary	3
1 Introduction	4
2 Review as part of a total framework for good regulatory decision-making	5
2.1 Information Disclosures	6
2.2 Improving the Legislative and Regulatory Provisions	6
3 Relevant Criteria for an Appropriate Review Scheme	8
4 The MEU Supports Model B	10
4.1 Maximising accountability	10
4.2 Maximising regulatory certainty	11
4.3 Maximising the conditions for the decision-maker to make a correct Initial decision	11
4.4 Achieving the best decision possible	11
4.5 Ensuring that all stakeholders' interests are taken into account, including those of service and network providers, and consumers	11
4.6 Minimising the risk of 'gaming'	12
4.7 Minimising time delays and cost	12
5. Model B: Who May Seek Review	13
6. Comments on Model A	16
6.1 Who may seek Review	16
6.2 Grounds for Review	17
6.3 Admissible Evidence	18
6.4 Other Material Before the Act	18
6.5 Procedure Generally and Costs	18
7. Responses to specific questions in relation to Model A	19
8. Responses to specific questions in Relation to Model B	23

Executive Summary

The Major Energy Users (MEU) Inc., representing some 20 major energy using companies, support Model B (judicial review) as the preferred appeals body and approach.

The MEU believes that regulatory error is considerably minimised as a result of the new regulatory framework established under the new legislation. Accordingly, the MEU considers that Model B will be the most efficient, timely and cost-effective approach.

However, because the specific requirements set out under the NEL and the proposed NGL to guide regulatory decisions, may open the door needlessly to excessive reviews, the MEU suggests that consideration be given to inserting an additional requirement that explicitly enables the regulator to exercise judgement and to balance the interests of network providers and consumers in regulatory decisions, thereby limiting the grounds for needless appeals.

The MEU strongly supports the view that bodies representing consumers should have standing to **commence** a Model B review, as well as individual consumers. Representative bodies should also have standing to **intervene** in a Model B review.

Because cost orders are powerful weapons and can seek to discourage consumers from intervening or commencing a review, they should be very narrow and confined to vexatious situations.

The underlying principles set out by SCO to guide the approach to merits appeal are not fully met by Model A with the appeals body acting in the shoes of the regulator (merits review).

The MEU considers that Model A will create regulatory uncertainty, encourage appeals by network service providers, result in undue delays and severely disadvantage consumer interests. Model A will encourage regulatory capture, as the regulator will be 'review shy' and err on the side of network providers.

Comments On The Discussion Paper On Decision-Making in the Gas and Electricity Regulatory Frameworks

1. Introduction

The Energy Markets Reform Forum (EMRF), the Energy Consumers Coalition of South Australia (ECCSA) and the Energy Users Coalition of Victoria (EUCV) have joined together to provide views on the discussion paper on the MCE's review of Decision-Making in the Gas and Electricity Regulatory Frameworks. The three groups – collectively referred to here as the Major Energy Users (MEU) – represent the interests of some 20 major gas and electricity users in Queensland, New South Wales, Victoria and South Australia.

MEU members have participated in nearly all gas and electricity regulatory reviews since the mid-1990's (including a number of gas coverage applications to the NCC) and consequently have a store of information and experience relevant to the current review. The MEU has also gained experience from the sole occasion (involving consumers as appellants) when a number of members appealed to the Australian Competition Tribunal against a Ministerial decision on coverage of a gas transmission pipeline (the Moomba-Sydney Pipeline).

The key 'take-out' from participation in these reviews is the very significant information and resource asymmetry faced by regulators and consumers on the one hand, and by network service providers on the other. This problem has also meant that consumers have been unable to participate (except on the odd occasion) as a stakeholder in appeals or merits reviews, either as an appellant, or as an intervenor. The costs involved in participating in merits reviews can be prohibitive for consumers. The fact that consumers have been largely unable to defend their interests before merits proceedings means that network service providers have an unwarranted and unfair advantage, a situation that strangely, has not apparently been of concern to the appeals bodies let alone policy makers.

This lack of a level-playing field should inform the MCE in its consideration of decision-making in the gas and electricity regulatory frameworks.

2. Review as part of a total framework for good regulatory decision-making.

The MEU agrees with SCO's key proposition that:-

"Review is not an end in itself, but a means to ensure accountability for regulatory decision-making. But review is not the only mechanism by which accountability is achieved and it must be part of a broader regulatory framework." (p2)

Thus, the MEU agrees with SCO's listing of the factors ((i) to (v)) that produce economically efficient regulatory outcomes, such as the new institutional structures stemming from the suite of MCE reform programmes, and the procedural and consultative requirements in the NEL, NE Rules and in the Gas Pipelines Access Regime (see pg. 2). Not only does this framework have the potential to produce economically efficient outcomes, but also, in the view of the MEU, the potential for minimising regulatory error.

However, the framework specified in SCO's list of factors conducive to economically efficient regulatory outcomes and the minimisation of regulatory error, is incomplete. MEU believes that **effective, well-informed and well-resourced end-user participation** is an essential factor conducive to good regulatory outcomes. The availability of procedural and consultative requirements in the NEL, etc. is a **necessary** but **insufficient** condition for good regulatory outcomes. Consumers have important views to provide in regulatory reviews and should be encouraged to make effective representations.

It has been the experience of MEU members in all regulatory reviews that network service providers commit vast resources to regulatory reviews. These resources cover legal, economic, financial, taxation and engineering expertise, far outweighing the resources available to end-users, let alone the regulators. Whilst it is to be expected that service providers have the self-interest to defend their business interests, they also have added incentives to do so, as expenses incurred are generally rolled into regulated revenues, which (ironically) are then paid for by end-users!

On the other hand, participation by individual major end-users has been **minimal**, and at best limited to a few specific issues. More extensive involvement, however, has come from consumer advocacy groups (mainly representing major energy users, such as the EUAA, EMRF, ECCSA and the EUCV) and this has largely been made possible as a result of members' funding and from funding provided under the National Electricity Consumers Advocacy Panel. Notwithstanding such participation, asymmetry in resourcing (and hence limitations in representation of consumers' interests) is very stark as between consumers and network service providers in regulatory reviews.

Thus, from the MEU's perspective, the "total framework for good regulatory decision-making" must include effective **consumer participation** and **advocacy funding**. In this regard, we note SCO has been examining this issue for some time, and the MEU looks forward to SCO delivering an outcome conducive to improving on consumer participation and advocacy funding. Ineffective and inadequate consumer participation in regulatory reviews can produce inefficient regulatory outcomes.

In addition to the need for competent and well resourced consumer input, MEU members consider that there are other **additional** key factors that require consideration within SCO's "total framework" for good regulatory outcomes. These are:-

- Transparency, timeliness and the adequacy of information disclosures at regulatory reviews; and
- Improving the provisions for "effective procedural and consultative requirements in the NEL and the NE Rules and in the Gas Pipelines Access Regime."

These additional key factors are discussed below.

2.1 Information Disclosures

In every regulatory review, (electricity and gas access arrangements reviews, and in gas coverage reviews) it is the clear experience of MEU members that service providers consistently 'game' the regulators by insufficient disclosure of information¹. These practices invariably test the regulators patience and diligence², prevent regulators and other stakeholders from establishing that proposed tariffs are fair, equitable and economically efficient, and generally cause undue delays and unnecessary costs. In the MEU's view, adequate information disclosures can reduce regulatory error (including in gas coverage reviews where NCC expertise in gas issues is limited) as well as enable end-users to participate more efficiently in regulatory reviews.

Particularly in the case where regulators are obliged to draft their own access arrangements, adequate information disclosures will reduce the likelihood of regulatory error and can even provide the disincentives for applications for merits review by service providers.

2.2 Improving the Legislative and Regulatory Provisions

¹ In the recent electricity distribution review in Victoria, United Energy opposed the regulator's request to the VCAT to source additional data that ESCoV considered essential for its review. Because United Energy has a complex ownership and operating structure, VCAT decided that the regulator's request was too expensive and too time consuming to be permitted!

² For example, the South Australian Independent Pricing and Regulatory Authority's Final Decision on the Envestra Access Arrangements application took four years to complete, with the regulator admitting that it did not have all the necessary information to assist in its final decision!

Related to the issue of information disclosure is that concerning the ambiguity of the Gas Code and Law in providing regulators with sufficient information collection powers to enable them to undertake their regulatory tasks. This ambiguity concerns:-

- the inability of the regulator (or otherwise) to specify the information required to be kept by service providers until a regulatory review commences (thus, amongst other things avoid unnecessary delays in the commencement of regulatory reviews); and
- the inability of the regulator (or otherwise) to obtain relevant information (and specify the type of information to be kept) in the face of changing (complex) corporate structures to ascertain that costs data (between related parties) are robust and at 'arms-length'.

These issues were debated extensively in the National Gas Pipelines Advisory Committee but never resolved largely because of strong opposition from network providers.

More recently, the difficulties in obtaining information on contracting out and related party contracts by the Essential Services Commission of Victoria as illustrated in an appeals case involving a pricing review of electricity distribution companies, underlines that the problem is widespread across electricity and gas, and requires timely resolution. Many network providers now operate their own network activities through shell companies or trust vehicles as part of their overall corporate structure. These vehicles undertake substantial transactions with related parties and regulators do need to establish their veracity and determine the cost effectiveness of the arrangements and the extent of the independence between the NSP and the contracted party.

The inability of regulators under the current gas law and code to pierce corporate veils underlies the MEU's concerns about adequacy of information disclosures in regulatory reviews and the support for efficient regulatory decisions and the need to minimise regulatory error. Clarifying the legislative and regulatory provisions to allow adequate information disclosures can ultimately limit the number and, even the extent of, merits appeals.

The MEU recommends that SCO pays particular regard to establishing an appropriate total framework for good regulatory decision-making that incorporates:-

- **effective, informed and well-resourced consumer participation and advocacy funding;**
- **transparent, timely and adequate information disclosures;**
and
- **adequate information collection powers (clearly demonstrated to be essential for a regulator to pierce corporate veils).**

The MEU considers that these additional framework elements will also minimise regulatory error and limit the number and extent of merits appeals.

3) Relevant Criteria for an Appropriate Review Scheme

The MEU agrees with the list of criteria cited in the Discussion Paper as relevant to developing an appropriate review scheme, viz.:-

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

Additional to the above list should be added:-

- Maximising transparency and information disclosures; and
- Providing adequate information collection powers to the regulator to pierce corporate veils and corporate trust vehicles to establish the robustness of related party transactions.

Economic regulation, no matter how professional and rigorous, is an art and not an exact science. As a result regulators have a difficult task in arriving at regulatory determinations, in accordance with the legislative and regulatory requirements that require arriving at decisions that are 'economic' and 'efficient'. But 'economically efficient' decisions (as provided under the NEL, NE Rules and Gas Access Regime) can have a very wide range of possible outcomes, for example in cost allocations which can range from avoided costs to standalone costs, and from short-term marginal costs to long-term marginal costs and even to depreciated optimised replacement costs. Regulators, therefore, invariably have to exercise judgements that seek to be fair and equitable to service providers and consumers. However, because they have exercised 'judgement' their decisions can become easy targets for merits appeals. The same concerns apply also to issues such as asset values, depreciation schedules, and rates of return (WACC), where depending on assumptions (and different expert opinions), a wide range of possible outcomes can be 'economically efficient' and hence deemed as appropriate.

Regulatory decisions are therefore, rather invidious and easily open to merits appeal. This is certainly the background experience with the Gas Access Regime, whereby every major ACCC transmission gas pipeline regulatory decision has been successfully appealed against by **well-funded** service providers to the Australian Competition Tribunal. In a similar vein, the appeal by ETSA Utilities against the very singular valuation of equity beta by ESCoSA, was assessed in isolation of the impacts of the other inputs to the valuation of WACC.

Affected consumers, however, have in nearly all such appeals, not been involved in the appeals proceedings largely due to the high costs of participation or being legally excluded. Because Tribunal Reviews are essentially legal proceedings (at the Federal Court level), the high cost of engaging legal (and other technical) representation easily outweigh any advantage that could be gained from participating and obtaining a positive outcome by any individual consumer, even for a very large consumer.

Even more disconcerting for consumers is the inability of **consumer groups** to have 'standing' in commencing proceedings in an appeals case (see the Tribunal's decision in respect of the appeal against the Commonwealth Minister's decision not to cover the Moomba-Sydney Pipeline as recommended by the NCC). In this case, the issue of (large and rising) legal costs (see also Gasnet appeal 2002) forced individual large corporate appellants to progressively withdraw from the appeal. What this meant was that a large stakeholder position was unable to be represented at an appeal hearing and consumers individually or as an association were effectively disenfranchised, with the effect that the appeal collapsed. The consequences are significant, and it is to be ascertained the extent of disadvantage consumers would face from a partially covered pipeline system.

In the MEU's view the enlarged criteria (for an appropriate review scheme) mentioned herein, together with the experience of lack of participation by consumers in appeals, should form the background for the consideration of the appropriate appeals body and the approach to be taken in merits review. This is discussed in the following section.

4. The MEU Supports Model B

Question 1: Do you prefer Model A or Model B?

The MEU strongly supports Model B.

Under Model B, the Federal Court would review the economic regulatory decisions of the AER in the context of specific requirements set out in the NEL and in the proposed NGL. In effect, the usual basis for judicial review has been augmented by the specific legislative requirements (which define the decision-making process and make explicit the basis for decision making). These provisions are to apply to economic regulatory decisions on electricity and gas transmission and distribution determinations. Ministerial decisions (being policy decisions) under the Gas Access Regime will also be appropriately subject to judicial review. The MEU strongly considers that this augmented review process meets all the criteria for an appropriate review scheme, especially in maximising regulatory accountability, minimising regulatory risk, and thereby stands the strong likelihood of reducing the number and the extent of merits reviews.

This model is consistent with the high-level underlying principles (see Section 1.10 of the Discussion Paper) for developing an appropriate review scheme, as discussed below.

4.1 Maximising accountability

Under Model B, the AER will be subject to higher accountability, as the Federal Court will have before it the specific requirements of the NEL and the NGL. These legislative requirements are specific and contain detailed provisions on how the AER must carry out its functions. It is noted that these legislative requirements augment the usual basis for judicial review. These requirements are set out under ss16, 35 and 36 of the NEL in relation to transmission determinations and should also be appropriate for distribution determinations under the NEL and for economic regulatory decisions under the NGL.

In addition, in the event of an appeal, as the Federal Court will not substitute its decision for that of the AER but will instead refer the matter back to the AER, there is an incentive for the AER to make a thorough and correct initial determination.

The MEU also considers that its suggested strengthened framework for good regulatory decision-making – in addition to those set out in ss 1.8 (i), (ii), (iii) and (iv) of the Discussion Paper – which encompasses (as we have suggested) transparency and information disclosures, adequate information collection powers to provide for more informed economic regulation, and well-resourced and informed consumer participation, will further add to maximising accountability and minimising regulatory error and strengthen the case for Model B.

4.2 Maximising regulatory certainty

The MEU considers that the reasons provided above in relation to maximising accountability apply also to maximising regulatory certainty. Because a judicial review under Model B will not encompass an ability by the Federal Court to substitute its decision (as the ACT would do under Model A) for that of the AER (but will refer the matter back to the AER), it does **not** create regulatory uncertainty, given the Court's limited expertise in energy and other non-legal matters.

4.3 Maximising the conditions for the decision-maker to make a correct initial decision

The MEU considers that the reasons given in 4.1 and 4.2 above will also apply to this particular principle as there will be pressure on, and incentive for, the regulator to "get it right" the first time.

4.4 Achieving the best decision possible

The MEU considers that the reasons contained in 4.1 and 4.2 above will apply to this principle. Because the court will not substitute its decision for that of the AER, but will remit the matter to the AER (with the possibility that it may give specific direction to the AER) there is a stronger probability that the best decisions possible will eventuate, as the appropriately resourced body (i.e. the AER) will be undertaking the revised review and not by a body (as proposed in Model A) which is inappropriately constituted to undertake the tasks.

4.5 Ensuring that all stakeholders' interests are taken into account, including those of service and network providers, and consumers,

The MEU considers that Model B is fully consistent with this principle, subject to the comments below on the issue of standing and who may seek review of regulatory and Ministerial decisions. The interests of service and network providers and consumers are not likely to be well-served by an appeals body (with all its limitations) acting in the shoes of the regulator. This is especially true, as has been the case hitherto, where consumers have not been able to participate in appeals, either through "standing" issues or through inadequacy of resources. A judicial review, limited in scope and time and **hence costs**, presents a stronger opportunity for consumers to participate in and hence have their interests taken into account. The current merits review process (Model A) for all intents and purposes, disenfranchises consumers from the proceedings. Model A, with the ACT acting in the shoes of the regulator, will likely be a protracted review process and substantially raise the costs of review proceedings.

4.6 Minimising the risk of ‘gaming’

The MEU agrees with the views contained in the Discussion Paper that Model A (but not Model B) is ‘highly likely to result in gaming and forum shopping by (rational and self-interested) energy providers.’ These can significantly increase regulatory costs.

The merits review body (under Model A) would need to be resourced with expertise (commissioners and technical staff) to reduce the risk of decision-making error. Unless this is undertaken, there will be an incentive on the part of energy network providers to ‘game’ not only the AER, but also the merits review body. In addition, because the merits review body does not provide a comparable investigative and consultative process to that which is used by the regulator, the interests of the range of stakeholders may be less likely to be factored into the final outcome. Importantly, as experience has shown in the past decade where, in the main, no consumer has fully participated in appeals before the ACT and NET (and therefore no contrary third party view heard), there is no confidence that Model A (with its extensive proposed provision of responsibility to the ACT) will not magnify the existing problems where circumstances (such as those mentioned later) have effectively disenfranchised consumers from appeal hearings. There is no apparent evidence that this has been a matter of concern to the ACT, but is nevertheless a real problem to consumers regarding the existing system.

4.7 Minimising time delays and cost

It has been the experience of the MEU that every network pricing and access review in energy over the past decade has been subject to extensive regulatory gaming. As a consequence, lengthy delays have eventuated with the attendant costs for users and potential users or access seekers. Model A, even in its ‘limited form’ of merits review by the ACT, is likely to continue to perpetuate lengthy delays and excessive costs. These act to the detriment of consumer interests.

5. **Model B: Who May Seek Review**

The MEU agrees with the point made in the Discussion Paper that the test for standing under Model B will be that of “a person who is aggrieved by a decision (ss. 5 and 6 of the ADJR Act). In addition, “a person interested in a decision” will be able to seek to become a party to the application for review of that decision (s. 5.12 of the ADJR Act).

The MEU agrees that the grounds for review will be as set out in ss.5 and 6 of the ADJR and that the following grounds:-

- (b) non-observance of procedures required by law to be observed;
- (f) error of law
- (h) lack of evidence or other material to justify the making of the decision

are of particular importance under Model B as they relate to the specific legislative requirements applicable to the AER’s economic regulatory decision-making (ss. 16, 35 and 36 of the NEL refers). These are stated as follows:-

- The national energy market objective must be taken account of;
- Registered participants in the NEM must be informed of material issues and given a reasonable opportunity to make submissions;
- A regulated transmission system operator must be provided a reasonable opportunity to recover its efficient costs of complying with regulatory obligations;
- Effective incentives must be provided to promote economic efficiency, including efficient investments and efficient service provision;
- The value of assets must be allowed for and regard had to any existing valuation.

The MEU, however, makes the following points:-

- The current system of economic regulation that is ‘light-handed’ and based on the building block approach including developing a regulated rate of return (WACC) that is based on the Capital Asset Pricing Model, is at best approximations to, on replications of, what might be outcomes in industries that face the rigours of competition, i.e. it seeks to replicate competitive outcomes.
- As illustrated above, the values for the RAB, depreciation schedules, and all the components of WACC can have wide ranges of values, depending on the assumptions and the theoretical models used.

- Economic regulation is not a precise science, and regulatory decisions based on concepts such as ‘recovering efficient cost’, ‘promoting economic efficiency’, ‘efficient investments’, etc. can have wide interpretations. For example, ‘economically efficient costs’ could range very widely from avoided costs to standalone costs and to depreciated optimised replacement costs.
- The issue of the derivation of WACC issue is a particular matter to note. For example, in the submission of the Treasurer of South Australia’s Review of the Essential Services Commission of S A electricity distribution price determination (which ruled on the review application by ETSA Utilities) in 2005, he said:-

“It is important to note that ESCOSA has made a Final Determination with respect to the electricity distribution network pricing for ETSA Utilities as a holistic and integrated determination.

In effect, the Final Determination is made “on-balance” after considering a range of input components. Probably, the best example of this is the Weighted Average Cost of Capital (WACC), where a range of components come together to determine an appropriate single rate of return.

ETSA Utilities has sought a review of only the equity beta component of the WACC, whilst leaving other components unchallenged. I note, however, that decisions on the components of the Final Determination are not taken in isolation, but rather taken together to form a collective view on a reasonable price, that is consistent with ESCOSA’s statutory guidance, in particular, protecting the long-term interests of consumers.

The Government notes that the inclusion of a “Q” factor correction, which effectively ameliorates the volume risk faced by ETSA Utilities, must systematically lead to a lower equity beta.

The approach of ETSA Utilities in what is effectively “cherry picking” perceived unfavourable components, is likely to be contrary to the long-term interests of consumers which, in the Government’s view, were met by the Final Determination.

It is the Government’s view that regulatory decisions are made “on-balance.” It is considered opportunistic to attempt to cherry-pick components of an overall WACC, which sits towards the upper end of the range of the most recent regulatory decisions for Australian utilities (apart from the QCA Final Determination which is expressed in post-tax nominal terms and is discussed elsewhere), as shown in the table below.....”

- A judicial review process that provides for review of regulatory decision-making that can be very widely interpreted or have a very wide range of possible values can readily open up all regulatory decisions to appeal.
- In the MEU's strong view, such easy access to review is highly undesirable and exposes regulators to 'regulatory capture' by network providers.
- The MEU considers that such a scenario (either large numbers of reviews or regulators becoming 'review savvy') undermines good regulatory decision-making.
- The MEU considers that the legislative requirements must be revisited and reconsidered to avoid further opening up of the avenues for easy reviews of regulatory decisions.

A key starting point is to provide, as a requirement, discretion for regulators to be able to exercise judgement and balance the interests of service providers and consumers, in order to avoid having a wide open avenue for reviews. This would reduce the likelihood of forum shopping by network providers and reduce the number of, and the extent of reviews.

6. Comments On Model A

The MEU does not support model A, but offers the following comments.

We are uncomfortable with “a limited form of merits review” proposal under Model A. Experience has shown that, especially (but not exclusively) in relation to appeals against one or two of the WACC elements, that limiting the consideration of the appeal to those few elements (and therefore excluding the other elements in the WACC assessment and the impact these other elements have on the decision) can jeopardise the balance of the regulatory decision on WACC. We consider that the Tribunal should be required to review other related elements of the WACC development and not simply focus on the specific elements on appeal.

But this flexibility should be **confined** only to the regulatory decision on WACC. We would not – indeed we are strongly opposed – to providing flexibility to the Tribunal to determine other issues in its own right, for example the methodology to apply to the regulatory asset base of the service provider, as happened in the EAPL appeal to the ACT against an ACCC determination. The assessment of asset value is another example of where the regulator must make a judgement, as many of the valuation methodologies are based on assessment.³

The Tribunal should review and make decisions on the basis of ‘error’ but we would be opposed to it having unprecedented powers to, for example, determine on its own the value of a regulatory asset (effectively what a decision of a methodology means) or to sit in the ‘shoes of the regulator’. This is not envisaged in our support for some flexibility for the Tribunal. As presently constituted, the Tribunal comprises a senior Federal Court judge, supported by a former State regulator and an economist with competition expertise. It does not appear, prima facie, that there is the requisite expertise in financial, accounting, taxation or even energy matters, which should seem to limit its ability to make its own determinations in many areas.

We consider that the Tribunal should not be able to decide in its own right what other aspects should be investigated. For the ACT to do so is effectively to **reproduce** the regulatory review, which after all, the regulator is better equipped to do and has more time to carry out more effectively. A regulatory review is a balance between many competing factors, and for the Tribunal to have the freedom to address other aspects in isolation (and without the comparable investigative and consultative process to that used by a regulator), opens up the opportunity for the whole balance of the review to be changed. This is highly undesirable and maximises the potential for decision-making error.

³ For example, even under the frequently used Depreciated Optimised Replacement Cost (DORC) method and the Optimised Deprival Value (ODV) method, different but experienced engineering consultants consistently arrive at different value for the same set of assets. So to expect a judicial review to be able to more accurately determine asset values is an unreasonable expectation.

6.1 Model A: Who May Seek Review

The MEU supports the proposal that standing to commence proceedings be restricted to service and network providers, the regulator and affected users. We are opposed to the qualification that affected users must “meet some type of high threshold” or “materiality test”. Given the high legal costs involved in appeals proceedings, it is unlikely that affected users will make frivolous appeals, thereby making it unnecessary to have the qualification currently envisaged.

Because of the high legal costs involved in such proceedings (and therefore they can be prohibitive even for individual large companies) the definition of “affected users” should be extended to include consumer advocacy groups (effectively enabling resource and costs sharing), providing that an “affected” user has been involved in the regulatory review.

We do not agree that a different standing test is appropriate nor do we see any validity in the argument that “coverage decisions directly and significantly affect persons other than network providers, for example, access seekers” (pg. 4). Coverage decisions do affect network providers and the thousands of consumers, which include upstream and downstream industries as well as domestic consumers, retailers and gas-fired generators.

6.2 Grounds for Review

MEU has difficulties with ‘limiting’ of the grounds of a review to:-

- Error of the fact finding by the decision-maker; and
- That the exercise of the decision-makers discretion was incorrect or was unreasonable.

These grounds for appeal are **far too wide**.

We have **strong** objections to providing the ACT “to correct regulatory error by substituting the correct or preferable decision”. The ACT has limited technical expertise beyond matters of law and legal interpretation. It is not qualified to substitute the correct or preferred decision involving complex energy, economic, technical, engineering and financial matters, particularly when changing one element can have an impact on another apparently unrelated part of the regulatory decision which as discussed above is a balance of competing goals. Nor does it (nor rather should it) have the time to make such decisions on regulatory decisions that, in most likelihood, had taken at least 12 months to arrive at following regulatory reviews. It is noted that the Full Bench of the Federal Court is due to make a decision in respect of an ACCC appeal against a Tribunal decision to substitute a decision on

the valuation methodology of the Regulatory Asset Base of EAPL (see later).

Because of time constraints of ACT proceedings and the limited (if not absence of) specialist expertise, it is undesirable for the ACT to go beyond finding that there has been an error in the findings. The regulator should be obliged to revisit the error and produce a new determination. The ACT should **not** be empowered to act akin to the “the original decision maker”. The implication of having another review on top of the original review undermines the whole foundation of the initial review, let alone raising very substantial costs and time delays. It is also inconsistent with the whole accountability framework for good regulatory decision-making, so ably noted in page 2 of the Discussion Paper.

As to the second ground of review (error in exercise of discretion), the MEU notes again that regulation is an art, not a science, and judgement needs to be exercised by the regulator – there can never be exact precision in such matters. To enable the ACT to stand in the shoes of the original decision-maker is to undermine the original regulatory review, add excessive costs and delays and (given its limited expertise) ultimately engender uncertainty. But if, of instance, de novo merits review is not proposed, it is questionable whether substituting a decision can be robust, let alone engender confidence in the new decision.

6.3 Admissible Evidence

The fact that “new material may be submitted and taken into account by the ACT in reaching the correct or preferred decision” (pg. 6) equates to a de novo merits review.

6.4 Other Material Before the ACT

The MEU considers it essential that legislative constraints are placed on the ACT to prevent shopping expeditions to re-open the initial regulatory review. We agree that this could include an obligation on the ACT to have regard to relevant AER policy documentation providing guidance on exercising its discretion in making the decisions.

6.5 Procedure Generally, and Costs

MEU supports the principle that each party bears its own costs and that an industry participant that brings proceedings but fails to make out any ground of review, should also meet the costs of the other parties.

It is noted that the time and costs involved in merits reviews are very substantial and do add significant delays to the decision-making process.

7. Responses to specific questions in relation to Model A

Question 2(a): Do you agree with subjecting the following decisions to Model A merits review:

- *AER decisions to draft and approve access arrangements or revisions to access arrangements in gas;*
- *Ring fencing decisions by the AER, including decisions not to approve associate contracts, in gas;*
- *Ministerial decisions in relation to coverage of gas pipelines; and*
- *For electricity, the AER's determinations on revenue caps for transmission network services, and ultimately distribution network services?*

The MEU does **not** support Model A.

There is some merit in applying a judicial review process to gas access determinations and harmonising the arrangements for both electricity and gas regimes. The MEU disagrees with the Productivity Commission's view in its Review of the Gas Access Regime, that the "prospect of exposure to imperfect regulatory instruments means there is a strong case for merits review" (pg.23). Economic regulation is in the realm of the second best and cannot expect to be perfect, therefore merits review provides an incentive for network providers to appeal regulatory decisions in the probability that these decisions can readily be 'rolled-back'

Question 2(b): Who do you consider should be able to commence Model A merits review in respect of:

- *Ministerial decisions on coverage in gas, and*
- *the specified AER economic regulatory decisions?*

The MEU does **not** support Model A.

The MEU considers that the enhanced framework for good regulatory decision making should maximise regulatory accountability and reduce the risk of regulatory error. In a world of the **second best** the regulator is able, at best, to arrive at decisions that seek to replicate competitive market outcomes and are judged to be fair and equitable to network providers and users, subject to ensuring security and reliability of service. As there is a requirement for balance between competing views, there cannot be any scientific precision to decisions. Providing access to merits review (as in Model A) encourages appeals by network providers, adds to lengthy delays and costs and disadvantages consumers. It would engender a regulatory world of the **third best**, where consumers usually are absent from appeals processes (for the various reasons detailed elsewhere in this response) and unable to put a third party view to the appeals body ready access to merits reviews can only further work against the interests of consumers.

Arguments that **property** rights are affected by these regulatory decisions should be seen in the context that these are **monopoly** interests earning effectively **guaranteed** returns; the price of a **franchise** to operate **monopoly** services must be economic regulation (in the public interest)⁴.

It should also be noted that in all regulatory decisions involving gas and electricity networks over the past decade, regulators have awarded rates of return exceeding those earned by major companies operating in competitive markets. It thus follows that the statement by network providers that “the costs and risks of allowing a faulty decision to stand outweigh the costs of, and delays caused by, merits review” (pg. 32) is weak. There is no evidence that network investments have been deterred by regulation (the Productivity Commission could not provide any evidence that the financial positions of network providers have been undermined and so reverted to a theoretical assumption based on economic principles that regulation must have impeded investment). On the contrary, there is evidence that regulators have been providing regulated returns that are higher than the norm for competitive industries.

The MEU does not consider that consumers face a level playing field in terms of participation in merits review. Consumers are either under-resourced or the gains for a single consumer entity are never significant enough to warrant seeking to appeal any regulatory decision. Thus the suggestion that industry participants have made in support of “a more onerous threshold test for standing to seek review” (pg. 32) is at best academic. The only likely prospect of consumers seeking standing to seek review will rest with consumer advocacy groups, who can represent a number of large (individual users) interests in **aggregate** and can be funded from a pool of funds contributed by a number of individual (large) users. This should provide for symmetrical standing, a position at least that is agreed even by the Productivity Commission.

The concept of a consumer advocacy group having standing can also be advantageous to consumers in general, as it could avoid any possibility for an individual large user that may have initiated appeals to withdraw, possibly at the behest of a service provider offering special treatment for that single large consumer.

In relation to standing to intervene in proceedings once they have commenced a wider range of persons should be permitted to intervene to put their views. These are persons “adversely affected”, or “aggrieved” by the decision and/or those with a “sufficient interest” in the matter. Here, again, consumer advocacy groups would be able to intervene

As to the ability to have the right of appeal following a gas access regulatory decision, MEU does not agree with the SCO suggestion “that only persons

⁴ Note that in the Western Australian Supreme Court decision on EPIC’s (Dampier to Branbury Pipeline) appeal against the Western Australian regulator, ‘public interest’ was determined to include consumers’ and network providers’ interests.

or entities materially affected should have the right to commence any merits review proceedings.....for example, large users whose economic viability would be adversely affected in a significant sense.....” (pg36). The significant costs involved in appeals make it unlikely that there will be vexatious appeals by consumers. There is no need to have the qualification.

As for coverage decisions, MEU considers that it is appropriate that any person can seek review as the issue affects potential access seekers other than network providers.

Question 2(c): Who should be able to join Model A merits review proceedings once they have been commenced and what issues should intervenors be able to raise with a decision?

Accepting that the MEU does not support Model A, the MEU considers that all affected parties (including groups of consumers) should be able to join in Model A merits review proceedings. They should be able to raise issues affecting them.

Question 2(d): SCO seeks comments from stakeholders as to the suggested grounds of review set out in Model A, in respect of both:

- *Ministerial decisions on coverage in gas, and*
- *the specified AER economic regulatory decisions.*

The MEU does not agree with Model A and supports Model B.

It is relevant for SCO to be aware, in the context of Model A, of the following ACCC appeal on the ACT's decision on the Moomba to Sydney pipeline⁵

“The Australian Competition and Consumer Commission today lodged an application with the Federal Court of Australia seeking judicial review of the Australian Competition Tribunal's decision on the Moomba to Sydney Pipeline (MSP) Access Arrangement.

The ACCC application is confined to the Tribunal's application of the law, consideration of evidence and reasonableness of its propositions relating to the methodology to be applied when establishing the initial capital base of the pipeline pursuant to the National Gas Code.

The Tribunal's decision, handed down on 8 July, rejected the valuation methodology applied by the ACCC and that proposed by the pipeline owner, East Australian Pipeline Ltd. Instead the Tribunal endorsed an alternative depreciated optimised replacement cost (DORC) methodology as the preferred approach for valuing the MSP. The

⁵ Australian Competition and Consumer Commission Press Release: MR/146/04, 4th August 2004

Tribunal's preferred methodology is to calculate the asset value by applying DORC based on the net present value of costs as opposed to DORC based on straight-line depreciation, which has been applied by regulators to date."

As of 27 October 2005, the Full Bench of the Federal Court has not ruled on the appeal.

A few key points should be noted in relation to this ACCC appeal:-

1. Following a regulatory review extending some 4 years, the issue has still not been ruled on. **This delay must be seen to have an impact on any assessment of regulatory certainty.** It would almost seem to be a view of at least one service provider appellant that "regulatory certainty" takes a clear second place to winning an increased return.
2. There was a clear case of forum shopping, involving applications to the NCC for coverage revocation of the EAPL pipeline followed by a Ministerial decision, which was subsequently appeal against, which was later withdrawn.
3. The ACCC's application to the Federal Court concerns significant issues surrounding the exercise of powers of the ACT, particularly in the application of the law and its decision on valuation methodology different to that applied by the ACCC and proposed by the access arrangement applicant. (Our underlining)

Question 2(e): Do you agree with the restriction on evidence proposed for Model A merits review in paragraph 6.60? Do you agree with the suggestion set out at paragraph 6.64?

Accepting that the MEU does not support Model A, the MEU agrees with the alternative solution to deal with the issue of new information as set out in s.6.61 (pg. 45).

As to the review policy to have regard to and take into account the AER's policy documents, there should be no avenue for departing from the AER's policy documents or it will add to regulatory uncertainty and perpetuate lengthy delays and costs.

Question 2(f): Do you agree with the proposal for awarding costs for Model A merits review in paragraph 6.67 or have any other views as to the costs of the review process?

The MEU agrees with the awarding of costs against appealing parties that have not provided any grounds for review. All parties should bear their own costs once acceptable grounds for review have been established.

8. **Responses to specific questions in Relation to Model B**

Question 3(a) Comment is sought on the central proposition of Model B: namely that the usual basis for judicial review should be augmented by specific legislative requirements to define the decision-making process and make explicit the basis for decision-making.

The MEU agrees.

Question 3(b): Do you agree with the approach in respect of Ministerial decisions on coverage in gas?

The MEU agrees.