

Regulatory Impact Statement

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

This RIS is for consultation only and should not be read as a settled or final view of the Standing Committee of Officials, or participating jurisdictions or the Ministerial Council on Energy regarding the framework for review of regulatory decision making. Additionally, the RIS does not represent any policy development on models A and B of the Discussion Paper released in October, and has been prepared solely to put the discussion in the earlier consultation paper into 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. Stakeholder consultation to that paper is being used to inform the policy decision on the preferred approach and will be used in the Impact Analysis of the Final RIS.

BACKGROUND

Two forms of review are available for decisions made in the electricity and gas sectors. The first, which applies to all decisions, is judicial review, whereby an assessment of the process undertaken is made to ensure due process has been followed and the decision is within the legal bounds proscribed by law. In addition, some decisions could be subject to merits review, where the relative merits of the decision are assessed and a preferred decision arrived at.

The Australian Energy Regulator (AER) and the Australian Energy Market Commission (AEMC) are subject to judicial review for decisions or conduct in relation to the National Electricity Market (NEM). The National Electricity Market Management Company Ltd (NEMMCO) is also subject to judicial review of its decisions and conduct under the National Electricity Law (NEL) and its decisions and conduct under the National Electricity Rules (NE Rules).

Decisions of the relevant minister in relation to coverage of gas pipelines are subject to merits review. The regulator is also subject to a limited form of merits review in relation to decisions on pipeline access arrangements.

The Productivity Commission (PC) reviewed that gas access regime and made two recommendations in relation to gas appeal processes. It proposes that the limitations on the grounds of appeal under s.39 of the Gas Pipelines Access Law be removed to allow a full merits review on access arrangements drafted and approved by the regulator. In addition, the Commission recommended that the material that can be introduced to the appeal body for a merits review of a coverage decision under s.38 of the GPAL should be restricted to material that has already gone before the primary decision maker.

The Standing Committee of Officials (SCO) has publicly indicated it will review the position relating to merits review in the electricity and gas sectors in the development of a response to the PC's Review of the Gas Access Regime. On 10 October 2005 it

released a detailed discussion paper (Review of Decision-Making in the Gas and Electricity Regulatory Frameworks) outlining two review options for the electricity and gas regimes. Model A (option 2 below) was for limited merits review and Model B was for judicial review (option 3 below). Submissions to that paper are informing the MCE's policy on the issue. This regulatory impact statement puts the options in the discussion paper into a format of a COAG regulatory impact statement which outlines the costs and benefits of the options on various stakeholders. Stakeholders are not expected to resubmit their policy positions on the options which they have already submitted to the discussion paper.

PROBLEM

The problem arises from the need to provide a regulatory framework that promotes the efficient investment in and use of energy infrastructure, such that economic regulatory decisions provide a balanced outcome between competing interests and protect the property rights of all stakeholders. An important part of balancing this is allowing parties affected by decisions appropriate recourse to have decisions reviewed. The current system of review in the electricity and gas sectors does not provide a consistent framework to support the efficient investment in and use of energy infrastructure.

In addition, the existing system of review in electricity distribution regulation needs to be restructured. Currently, the review mechanisms differ across states. The transfer of distribution regulation to a national framework by 2007 requires consideration of a national review mechanism.

The appropriate review mechanisms should aim for the optimal decisions possible within a framework where the benefits of the review outweigh the costs to stakeholders.

OBJECTIVE

To establish an appropriate scheme for review of decision-making in the gas and electricity framework that endeavours to:

- 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";
- Minimise time delays and cost.

SCO has suggested that the following types of regulatory decisions (described as 'economic regulatory decisions') are suitable for review:

- decisions by the Australian Energy Regulator (AER) and Ministerial decisions in relation to gas which are currently subject to review under ss.38 and 39 of the Gas Pipelines Access Law (GPAL); and

- in electricity, AER decisions relating to determinations on revenue caps for transmission network services and, ultimately, distribution network services.

OPTIONS

Option 1 - Status Quo – continue with the current system of reviews within the NEM and the proposed National Gas Access Regime.

Gas

The Gas Pipelines Access Regime currently includes two review rights each relating to different types of decisions, and each with different grounds of review available (see GPAL ss.38 & 39). The decisions, which are presently subject to some type of merits review, are:

- Decisions of a Regulator to draft and approve an access arrangement or revisions to an access arrangement (focus most often on the reference tariffs set out in those arrangements);
- Ring fencing decisions (that can impose obligations relating to business structures to deal with vertical separation of related businesses, including decisions not to approve associate contracts); and
- Decisions of Ministers in relation to coverage of pipelines (these are decisions on whether a pipeline owner or operator is to be subject to a regulatory regime rather than being able to operate in a competitive market environment).

In relation to decisions to which it applies, s.38 provides a wide type of merits review (although there are some restrictions on a s.38 review). In relation to decisions to which it applies, s.39 provides a more limited merits review restricted to correction of error.

Both the review provisions in the GPAL restrict the scope of the review in a number of ways. For example, only specific categories of persons have standing to seek review; the types of decisions that may be reviewed are limited; and the available grounds of review are limited particularly in relation to access arrangements (s.39). In the case of review of decisions about coverage and ring fencing under s.38, the Australian Competition Tribunal (ACT) has, as a matter of practice, not seen its task as a true *de novo* hearing but rather one restricted to the matters raised in submissions by the parties. Similarly, the ACT cannot admit new information as a matter of law under s.39 and has insisted on relevant information as a matter of practice in reviews under s.38.

Electricity

Sections 16, 35 and 36 of the new National Electricity Law, by defining the AER's decision-making process and making explicit the basis for its decision-making, have significantly increased the scope for judicial review of economic regulatory decisions under the NEL and NE Rules. These sections set out key principles in relation to how the AER must exercise its economic regulatory functions. Failure to comply with these requirements will be an error of law and subject to judicial review by the Federal Court pursuant to the *ADJR Act*. There is currently no system of merits review of AER economic regulatory decisions in transmission regulation.

It should be noted that the current system of review for electricity distribution regulation cannot be maintained as it is different in each State and is in the process of being

transferred to a national framework. However, some of those electricity distribution decisions are subject to merits review.

In light of the MCE's objectives for consistent framework for review and the pending transfer of responsibilities to the AER, the status quo is not a preferred alternative for the MCE to adopt.

Option 2 - Limited merits (administrative) review by the Australian Competition Tribunal (ACT).

The ACT would undertake a limited form of merits review of the economic regulatory decisions of the AER in the case of gas and electricity, and of relevant Ministers in the case of coverage of gas pipelines. These decisions have a substantial impact on the economic viability of network and service providers. In addition, the decision-making power involves the exercise of significant amounts of discretion, so that judicial review is arguably not sufficient and a form of merits review may be justified on policy grounds.

There are many models of statutory merits review, but they tend to fall into two groups:

1. Full merits review - on any grounds, and where the review body “stands in the shoes” of the original decision-maker, and is given all the powers of the original decision-maker. The review body can make a fresh decision, can take into account fresh information and in all aspects, the review body is the decision-maker.
2. Limited merits review – where key aspects of the review rights available are constrained by placing limits on any or all of:
 - *The types of decisions (or parts of decisions)* that are to be subject to review;
 - *Those who may apply for review* so that persons must satisfy a threshold to seek review, eg those who have previously participated and/or are “adversely affected” or “aggrieved”; versus “any person” which is in effect a full third party appeal right;
 - *The grounds of review* so that only specific grounds are available that focus on key aspects of decision-making where unchecked regulatory error has significant adverse impacts;
 - *The powers and remedies* available to a review body to correct regulatory error but also to safeguard against the high costs of unjustified or unwarranted review applications;
 - *The evidence* that the review body may take into account.

A merits review scheme with certain limitations is proposed below in order to balance the costs and delays involved in merits review, and the fact that the decisions have usually been reached after extensive public and consultative processes.

Who may seek review

For the AER's economic regulatory decisions in gas and electricity (excluding coverage decisions by relevant Ministers in the case of gas pipelines), the proposal is that standing to commence proceedings be restricted to service and network providers, the regulator, and affected users who meet some type of high threshold or “materiality” test.

However, once proceedings have been commenced in relation to a particular regulatory decision, then a wider range of persons will be permitted to intervene in the proceedings to put their views, such as persons “adversely affected” and/or those with a “sufficient interest” in the matter. There could be specific provision to allow for consumer advocacy groups to intervene in a matter. The role these parties may have in alleging that the original decision was in error on grounds other than those already raised, would need to be determined.

However, under Option 1, it may be that a different standing test is appropriate in respect of gas coverage decisions as coverage decisions directly and significantly affect persons other than network providers, for example, access seekers.

Grounds of review

The proposed merits review is restricted in its grounds of review. This differs from the Productivity Commission’s review recommendations, which recommends a removal of the restrictions on grounds of appeal under section 39 of the GPAL, such that the review scheme would be a full merits review format. Under Option 2 it is proposed that the grounds of review will be limited to:

- a) error of the fact-finding by the decision-maker; and
- b) that the exercise of the decision-maker’s discretion was incorrect or was unreasonable having regard to all the circumstances (described in this paper as “error in exercise of discretion”).

These grounds are similar (but not identical) to the existing grounds of review in s.39(2) of the GPAL.

These grounds of review, combined with a power to correct regulatory error by substituting the correct or preferable decisions, will allow the ACT to do more than a court can do under judicial review, but limits the administrative review to something less than a full re-exercise of the power to make the decision.

(a) First ground of review: error of fact-finding

The ACT may intervene where it considers that there has been an error in the findings of fact. The fact-finding task of an administrative decision-making body is fundamental to good quality decision-making, and if the facts upon which a decision is based are incorrect, or material facts are not available to the decision-maker, when the decision is made, the rational basis for the decision is in doubt.

In judicial review, courts will only interfere with the findings of fact of the original decision-maker where an error of law occurs – for example, where that person or body has made a decision based on “no evidence” at all for the finding of fact. But if there is some cogent evidence, the court will not go further to determine whether they are the “correct” facts. However, the limited merits review proposed, permits a much greater level of scrutiny by the review body around the fact-finding task, and places the review body in the shoes, as it were, of the original decision-maker.

Importantly, it is not suggested that an applicant for review should be able to introduce new information before the review body in order to establish an error in the findings of fact. The ACT would make this assessment based on the information that was before the original decision-maker.

(b) Second ground of review: error in exercise of discretion

The complexity of some of the economic regulatory decisions discussed in this RIS is such that there is a need for the regulator to exercise broad discretion in arriving at its determination.

Judicial review by a court to ensure that an administrative decision-maker has not abused a discretionary power conferred by law includes grounds such as the need to consider relevant considerations in the exercise of the power, not to make a decision for improper purposes taking into account the statutory scheme, and the test of *Wednesbury* unreasonableness. Each of these judicial review grounds is intended to allow a large degree of deference to the original decision-maker in the exercise of the discretionary power. So, for example, a court can only intervene on grounds of unreasonableness where the decision by the AER, for example, is so unreasonable that no reasonable person could have come to the decision. A court cannot and does not stand in the shoes of the original decision-maker. This merits review ground allows the ACT to scrutinise the discretion exercised by the decision-maker, taking into account a wider range of circumstances than judicial review would allow.

The ACT can decide whether, in all the circumstances, it agrees with the reasoning, judgments and choices made by the original decision-maker. If the ACT considers it made an error, or the decision was unreasonable in a less onerous sense than the judicial review *Wednesbury* sense, then the ACT would have the power to re-exercise the power to the extent necessary to address the error, and to this extent has all the powers of the original decision-maker. But rather than being directed towards an examination at large, this merits review ground allows the ACT to focus on those matters that it considers being of sufficient weight and importance to make out the specified ground of review.

Powers and remedies

The ACT will have all the powers of the original decision-maker in order to enable the ACT to review on the facts and on the discretion and, if it chooses, to substitute the correct or preferable decision. To this extent, the ACT will “stand in the shoes” of the decision-maker, but this does not equate to a requirement to re-do any or all of the process leading to the original decision.

The ACT will be able to:

- Affirm the decision of the AER or other relevant decision-maker that is under review;
- Vary the decision that is under review;
- Set aside the decision that is under review and either:
 - make a decision in substitution for the decision set aside; or
 - remit to the AER or other relevant decision-maker for reconsideration in accordance with any directions or recommendations.

If the NEL or NGL so allows, the ACT will be able to suspend the operation of a decision pending the review.

Admissible evidence

The ACT will be able to consider all the material that the original decision-maker had before it at the time of the decision. An applicant will not be able to introduce new information, issues or matters before the ACT to establish the grounds of review, however, it is proposed that if the ACT decides on the same material that was before the decision-maker that there is regulatory error of fact or discretion according to the grounds of review, then new material may be submitted and taken into account by the ACT in reaching the correct or preferred decision as at the date of the ACT's decision. This is in line with the Productivity Commission's recommendations.

There could be legislative criteria setting out the circumstances in which new evidence may be admitted by the ACT. For example, new evidence could be admitted where, in the opinion of the ACT, it would be unreasonable not to admit the evidence taking into account all the circumstances, including where the evidence was not available or not known at the time of the original decision and could not reasonably have been made available or known. The ACT will also have supporting powers to make directions to exclude irrelevant material generally and these powers would similarly apply to any new evidence proposed to be submitted.

Other material before the ACT

Legislation could impose an obligation on the ACT to have regard to relevant AER policy documentation providing guidance as to how to exercise its discretion in making the economic regulatory decisions specified.

Procedure generally and costs

Currently, reviews by the ACT are mostly conducted on the basis that each party bears their own costs, in recognition that merits review is not an adversarial court process but more a formal administrative mechanism to reconsider and correct that decision. However, consideration could be given to other approaches. Some merits review bodies have a limited ability to make orders as to costs as is currently the case with s.38(10) of the GPAL.

As an applicant may force a considerable number of parties (including the decision-maker) to great expense over a decision, it may be possible for there to be discretion for the ACT to make an award as to costs against an applicant who has not succeeded in making out any ground of review. Where an industry participant brings proceedings and fails to make out any ground of review, it may be appropriate that, as a general rule, that participant meet the costs of the other parties, save in exceptional circumstances. However, where a ground of review has been made out, all parties would bear their own costs.

Application and other fees (such as a daily hearing fee) may be payable. But any such fees would only be to recover some of the administrative costs of the review and would not be set as a prohibitive barrier to making a review application.

Option 3 - Judicial review by the Federal Court of the economic regulatory decision-making of the AER.

The Federal Court would review the economic regulatory decision-making of the AER in the context of specific requirements set out in the new NEL and the proposed NGL.

The new NEL provides an example of how the scope for judicial review can be significantly increased if the legislation governing a decision-maker makes express and detailed provision for how the decision-maker must carry out its functions. This means that the Court will review compliance with those legislative requirements in relation to both the process followed by the decision-maker and the decision made. The usual basis for judicial review has, in effect, been augmented by the specific legislative requirements.

This option is based on the example of ss.16, 35 and 36 of the new NEL in relation to transmission determinations. These sections define the AER's decision-making process and make explicit the basis for that decision-making. Under this option, the same approach would be taken for:

- other economic regulatory decision-making to be provided for in the NEL – that is, distribution determinations; and
- economic regulatory decision-making under the NGL.

Under this judicial review, because the Federal Court will have before it the specific requirements of the energy legislation, regulatory errors that have adverse economic effects will be more readily corrected than would be the case if the Court were able to consider only such issues as procedural fairness or jurisdiction.

In addition, it is proposed that judicial review will apply to Ministerial decisions that are currently subject to review under s.38 of the GPAL. This is on the basis that such decisions are essentially policy decisions (hence they are decisions made by Ministers) and therefore merits review by an administrative tribunal is not appropriate. In other words, judicial review is the appropriate form of review, consistent with general principles for review by the courts of decisions made by government.

Sections 16, 35 and 36 of the new NEL:

- set out key principles in relation to how the AER must exercise its economic regulatory functions;
- make explicit the basis for its decision-making; and
- define the decision-making process.

Failure to comply with these requirements will be a basis for judicial review. More importantly, the Court will, in light of these requirements, be able to examine in detail both the nature of the decision required to be made and how the decision-maker has carried out its functions.

Who may seek review

The test for standing will be that of “a person who is aggrieved by a decision”: see ss.5 and 6 of the *Administrative Decisions (Judicial Review) Act 1977* (Cth) (*ADJR Act*). This will ensure that the formulation for who may seek review of the AER's economic regulatory decisions is consistent with that for judicial review of other decisions by the AER.

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: see s.12 of the *ADJR Act*.

Grounds for review

The grounds for review will be as set out in ss.5 and 6 of the *ADJR Act*. These grounds are summarised below:

- a) Breach of natural justice;
- b) Non-observance of procedures required by law to be observed;
- c) Lack of jurisdiction on the part of the decision-maker;
- d) The decision was not authorised by the relevant legislation;
- e) Improper exercise of power by the decision-maker;
- f) Error of law;
- g) Fraud;
- h) Lack of evidence or other material to justify the making of the decision; and
- i) The decision was otherwise contrary to law.

Of these grounds, (b), (f) and (h) will be of particular importance under this option, since these will relate directly to the specific legislative requirements applicable to the AER's economic regulatory decision-making. In the case of the new NEL, ss.16, 35 and 36 require that:

- 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.

Failure to comply with these requirements will be an error of law and subject to judicial review by the Federal Court under Option 3. For example, if the AER does not, in making a transmission determination, have regard to a valuation of assets forming part of the relevant transmission system applied in any relevant determination or decision, as required by both s.16(2)(d) and s.35(3)(c) of the NEL, this will be an error of law and review on this basis could be sought in the Federal Court.

Powers and remedies

The Federal Court will have the powers and remedies available under the *ADJR Act*. In particular, under ss.15 and 16 of that Act:

- The Court will be able to suspend the operation of a decision pending the review.
- The orders available to be made by the Court will be:
 - to quash or set aside the decision in whole or in part;
 - to refer the matter back to the AER for further consideration in accordance with the Court's directions; and
 - declaration, mandamus or injunction.

Procedure generally and costs

The general rule in judicial review proceedings is that "the costs follow the event", that is, the party that loses the proceedings is usually ordered to pay the costs of the other parties involved. The costs order should, however, reflect the degree of success attained and a successful party may be ordered to pay some costs in respect of unsuccessful aspects of the case.

Standard Federal Court application and other fees would be payable.

Admissible material

Courts in judicial review proceedings can take into account fresh evidence in certain circumstances. In *ADJR Act* proceedings heard by the Federal Court, matters occurring after the making of the decision under review may well be relevant to the exercise of the Court's discretion. It is clear that the Court will be able to allow additional material to be adduced that, in the opinion of the Court, will assist it to deal with the matter before it.

Option 4 - De novo (full) merits review is a possible option with high costs involved.

A *de novo* or full merits review regime is unrestricted on grounds, and where the review body "stands in the shoes" of the original decision-maker, and is given all the powers of the original decision-maker. Full merits review involves a broad ability to stand for appeal by many interested parties, such as end users and consumer advocacy groups. In addition, the review body can make a fresh decision, can take into account fresh information and in all aspects, the review body is the decision-maker.

The Productivity Commission's proposed merits review regime is in effect a full merits review scheme limited in the evidence available to the decision maker, such that material that can be introduced to the appeal body for a review is limited to material that has already gone before the primary decision-maker. It is questionable whether this would significantly limit the costs of *de novo* review.

It should be noted that *de novo* review is not proposed under any of the other options.

IMPACT ANALYSIS

Major stakeholders that are likely to be affected by the following options include: electricity generators and natural gas producers, energy retailers, network service providers, major energy users, final consumers, regulators and governments (both State/Territory and National).

Option 1 – Status Quo

Benefits

- The current system of reviews is understood by all stakeholders in the energy market and a system of precedent has been developed to interpret it.
- There would be little to no implementation costs to governments.

Costs

- The difference in the gas and electricity review schemes may have the potential to distort investment between gas and electricity. It has been argued that investors may reduce investment in electricity where there is no review mechanism to protect their interests as the lack of review increases the riskiness of investment.
- The real economic cost of this option arises from the efficiency benefits foregone by not implementing an option that increases opportunities for investment in both the electricity and gas markets.
- The effectiveness of judicial review in the electricity industry has not been tested.

Option 2 – Limited Merits Review

Benefits

- **Correction of a greater range of regulatory errors than judicial review**

If the types of decisions of a body or person require high levels of discretion and involve complex economic concepts with layers of small, inter-related judgements that together form a final, holistic determination, stakeholders may argue that the reach of judicial review is not adequate to address regulatory error that may have significant adverse consequences on participants, and that a more extensive type of review, such as the right to review on the merits, is justified. Merits review would provide a more extensive type of review than judicial review, and enable correction of a greater range of regulatory errors that may have significant adverse consequences on participants, including network service providers.

Judicial review has the potential to leave in place regulatory errors that may have adverse economic effects. However a merits review process more readily enables the correction of such errors.

- **Higher accountability for decision-makers**

The existence of a merits review scheme promotes high quality primary decision-making. Merits review can lead to increased awareness amongst the AER and relevant Ministers about the exercise of the decision-making powers within the terms of the energy legislation, promote the consistent application of the law by these decision-makers, and can result in decision-makers being more careful to avoid error in their decisions. While judicial review provides an incentive to the decision-maker to ensure that the initial decision is correct, an additional layer of review, such as merits review, may provide even more incentive to the decision-maker to make a correct primary decision.

- **Limited merits review to balance competing interests**

There is inevitable tension between not revisiting regulatory decisions reached after lengthy and expensive consultative processes on the one hand, and taking into account the interests of network and service providers whose economic viability may depend on the regulator's or Minister's decision, on the other hand. A limited merits review scheme such as Option 2, balances the competing interests involved.

- **Review by specialist tribunal can be an advantage**

With appropriate resources and access to experts (where necessary), the ACT could have the expertise and capacity to deal with the complex regulatory concepts arising in energy matters. The ACT as a specialist administrative tribunal has considerable experience in dealing with economic regulatory matters. In addition, the tribunal's presidential member, a Federal Court judge, can determine questions of law that arise in the course of the hearing, so that there may be consideration of both errors of law and factual errors made by the decision-maker.

An important aspect of Option 2 is that the ACT can substitute its decision for that of the AER or relevant Minister, rather than remitting the matter back to the primary decision-maker for reconsideration. The ACT "can stand in the shoes" of the original decision-maker. However, where the ACT considers that it does not have the expertise to decide a particular issue, it would also be able to send the matter back to the decision-maker for reconsideration.

- **Reduced gaming by regulated entities through limitations**

A merits review scheme limited in significant respects will lessen the incentive of regulated entities to "game" the process. For example, regulated entities will have little incentive to withhold important information from the AER or other decision-maker because of the significant restrictions on the admission of new evidence.

- Limitations on the grounds of review (as proposed by Option 2) enable some deference to be given to the decision maker who is best placed to balance divergent views raised by an extensive consultation process while still ensuring that material regulatory errors can be corrected.

Costs

- **Potential to be biased towards regulated entities**

A commonly expressed concern with merits review is that it is highly likely to result in gaming and forum shopping by (rational and self-interested) energy providers. The discussion paper outlines three key considerations which factor against merits review of economic regulatory decisions:

1. the nature and complexity of certain regulatory decisions will increase the risk of regulatory error if the merits review body is not at least equally resourced with expertise;
2. the interests of the range of stakeholders may be less likely to be factored into the final outcome as the merits review body does not provide a comparable investigative and consultative process to that which is used by the regulator; and
3. the time and cost of conducting such merits reviews are very substantial and can add significant delays to the decision-making process.

These are particularly a concern under a full merits review scheme, however the limitations on the merits review under Option 2 endeavours to reduce these gaming incentives.

- There can be a 'free-rider' problem involved with merits review. Since the costs of a regulatory error are spread across all users, it is very unlikely that an individual user

will pursue an appeal as they would bear the costs of the appeal, but any benefits from the correction of the regulatory error would be spread across all users.

- While various ACT decisions may be cited by some as proof of the need for merits review in the energy sector, the Federal Court has also dealt competently with complex economic issues in that sector. Therefore, it can be argued that there may be no particular advantage in having review by a specialist tribunal and it may only impose additional costs.
- End users may not have the resources to participate, while service providers with greater resources can be heard again and push their interests further. A big cost of appeals is the additional costs forced on consumers by the inroads made by network owners accessing reviews.
- There are large costs to the regulator of running an electricity or gas merits review of up to \$1 million. This may entice the regulator to make decisions biased towards service providers in the knowledge that their decisions are unlikely to be appealed by end users who do not have the resources to get involved.
- This option limits access to appeals in the gas industry relative to the current arrangements. This cost will be incurred by gas industry participants.

Impact on stakeholders

Electricity Generators and Gas Producers

There will be little impact on electricity generators and gas producers under this option. However, the reduction in the grounds of review for the gas regime relative to the current situation may have a slight impact on gas producers.

Network Service Providers

A merits review scheme would benefit service providers by providing a greater incentive for the regulator to make the appropriate decision in the first case, thus reducing any negative impacts that a poor economic regulatory decision may impose on service providers. A wide range of regulatory errors could be corrected on review thus decreasing the risks for network investment. The restrictions on the merits review scheme (as proposed under Option 2) can benefit network service providers by limiting the ability to apply for review to the service providers. Thus, the decision-makers may be inclined to make decisions with the interests of the network service providers in mind. However, these restrictions also reduce the decisions for which network service providers could appeal as compared to a full merits review scheme.

Energy Retailers

There will be little impact on energy retailers under this option, as any additional costs they must pay to network service providers would be passed on to end users.

Major end users and consumers

A limited merits review with limited standing to appeal (as proposed under Option 2) would disadvantage major end users and consumers of energy, as they would be unable to apply for an appeal. Generally, small to medium end users do not have the resources

to apply for a review of decisions. This may result in decision-makers making decisions with the interests of network service providers in mind, as they would be the only parties able to appeal. However, restrictions on using new evidence and a wide ability to intervene in proceedings would mitigate many of the disadvantages of the status quo.

Regulator

The regulator may have to pay large costs when undergoing review. In addition, following the ACT's assessment, the regulator may need to re-make the decision which again could result in large costs and time delays for the regulator. The introduction of a merits review system will encourage regulators to take a lot more time and consideration into the decision-making process in order to deter future appeals, again increasing the costs to the regulator. The limited merits review option proposed attempts to limit time and costs of the review process. If a full merits review option was adopted, the costs and time delays placed on the regulator would be significantly greater than those imposed under Option 2.

Governments

Governments would have to bear the costs imposed onto the regulators of the review scheme. Thus, Option 2 presents a more beneficial scheme for Governments than a full merits review system as it reduces the costs and time delays involved in the review process.

Option 3 – Judicial Review

Benefits

- **Legislative accountability for the AER**

The AER will be subject to the discipline of the specific requirements set out in the energy legislation. As noted, those requirements will set out key principles in relation to how the AER must exercise its economic regulatory functions, make explicit the basis for its decision-making and define the decision-making process.

One essential difference between Option 2 and this option is that the Federal Court will not substitute its decision for that of the AER but rather will remit the matter to the AER (and, in doing so, the Court may be prepared in appropriate cases to give quite specific directions to the AER). Review, whether judicial or merits, is an incentive to the decision-maker to make a correct initial decision. The incentive will be high if the decision-maker knows that the decision will be returned to it for remaking. In particular, any inclination on the part of the decision-maker to act in the expectation of having its decisions substituted by a review body will be avoided.

- **Little incentive for “gaming” by regulated entities**

Because Option 3 does not involve a review body making a new decision, regulated entities will have little incentive to hold back critical information from the AER or otherwise “game” the process (compared to, say, merits review without limitations on admissible evidence).

- **Avoiding multiple actions in respect of the same matter**

The right to judicial review is a given. If merits review by a tribunal applies as well, the potential will exist for multiple actions in different forums in respect of the same AER decisions. This will be avoided under Option 3.

Option 3 will locate all review of AER economic regulatory decision-making in the Federal Court. This will substantially streamline regulatory processes consistent with the MCE's reform objectives, promoting further confidence in the regulatory regime.

- **Minimising costs and time delays – maximising regulatory certainty**

Reducing the potential for multiple actions in respect of the same AER decisions will also assist in minimising costs and time delays associated with reviews and maximising regulatory certainty. If review is limited, there will be greater certainty around economic decision-making. All parties would be able to appeal to one forum where all their issues concerning the decisions could be raised.

Further, as noted above, the AER's decision-making process will involve an extensive inquiry process that would be both time-consuming and costly to repeat on review. The Administrative Review Council (ARC) guidelines indicate that, where a decision involves an extensive inquiry process, merits review may not be justified.

Costs

- Remitting a matter back to the original decision-maker for reconsideration can impose significant costs and delays on the parties involved.
- Judicial review can be quite costly and complex. Given the diffuse nature of any potential benefits, it can be an unattractive option for users and other interested third parties.
- Judicial review will not allow the correction of a broad range of regulatory errors. It may allow a faulty/improper regulatory decision to endure, causing significant costs to affected network service providers whose 'interests' are in effect property rights.
- Error in economic regulatory decisions, if left to stand, may impose significant costs on large users of electricity and gas, and therefore society as a whole.
- Having only a judicial review scheme will result in more decisions being appealed with issues of merits dressed up as judicial problems.
- If discretions of the regulator are reduced too much under this option, so that judicial review can operate efficiently, the decision-making process may become overly mechanical resulting in less optimal decisions being made. Discretion is often needed in economic regulatory affairs to balance interests.

Impact on Stakeholders

Electricity Generators and Gas Producers

There will be little impact on electricity generators and gas producers under this option.

Network Service Providers

A judicial review scheme does not provide the same kind of incentive as merits review would for the regulator to make the appropriate decision in the first case. This could result in inappropriate but lawful decisions being made by the regulator, which could have large negative impacts for the service provider with no ability to appeal the decision. Service providers would need to ‘dress up’ merits review issues as legal issues in order to apply for an appeal. In addition, property rights would not be protected in the same way and the riskiness of investments would increase.

Energy Retailers

There will be little impact on energy retailers under this option, as any additional costs they must pay to network service providers would be passed on to end users.

Major end users and consumers

Depending on the limitations to standing, a judicial review may not enable end users to appeal a regulatory decision. However, it may reduce the influence of service providers on the review scheme and thus result in less incentive in ‘gaming’ from service providers and a just review system for end users. This option may allow the regulator to favour consumer interests more in the initial decision.

Regulator

The regulator may have to pay large costs when undergoing review. In addition, following the ACT’s assessment, the regulator may need to re-make the decision which again could result in large costs and time delays for the regulator. However, regulators would be spared the costs of merits review. Nonetheless, this form of accountability and its associated costs cannot be removed.

Governments

Governments would have to bear the costs imposed onto the regulators of the review scheme.

Option 4 – De novo/full merits review

It is assumed that a *de novo* merits review regime is not likely to be implemented because of the high costs imposed, the regulatory uncertainty and the sheer impracticality of a review body re-making a complex economic determination that was the product of lengthy consultative process.

SCO considers that any review of the specified economic regulatory decisions should be limited in some respects. Policy considerations suggest that review be of only some types of errors. Factors that indicate there should not be a *de novo* merits review include:

- Where a wide, transparent public consultation process has already been undertaken by an expert body;
- Where there is no one correct answer for a particular regulatory setting and only a high level of error should reasonably be corrected;

- Where there is scope for gaming of regulatory decisions (eg. withholding of information, delay etc); and
- Where costs and delays involved in a wider type of review would be significant.

Benefits

- Full *de novo* merits review may result in the most efficient decision making as the review body makes its decisions in accordance with well understood principles.
- If additional errors were made in a decision, other than those chosen to appeal against, it is likely that a full rehearing of the decision-making process would uncover these errors and resolve them appropriately.
- While the cost of reviews will almost certainly always be pushed onto consumers, the introduction of a full merits review scheme would provide end users with a greater power to appeal decisions, encouraging decision-makers to consider the needs of end users when making their decision.

Costs

- Revisiting regulatory decisions reached after lengthy and expensive consultative processes can be extremely costly and time consuming and may defer the decision-making process for some time.
- A full merits review scheme would increase gaming opportunities by allowing the review body to take new information into account, thus encouraging interested parties to omit information to the original decision-maker and introduce it to the review body.

Impact on stakeholders

Electricity Generators and Gas Producers

There will be little impact on electricity generators and gas producers under this option.

Network Service Providers

A merits review scheme would benefit service providers by providing a greater incentive for the regulator to make the appropriate decision in the first case, thus reducing any negative impacts that a poor economic regulatory decision may impose on service providers. A wide range of regulatory errors could be corrected on review thus decreasing the risks for network investment. A *de novo* or full merits review scheme would enhance the types of decisions for which network service providers could appeal, however with no limits on who can apply for an appeal, decision-makers may bias their decisions more towards end users.

Energy Retailers

There will be little impact on energy retailers under this option, as any additional costs they must pay to network service providers would be passed on to end users.

Major end users and consumers

The cost of reviews will almost certainly always be pushed onto consumers, thus a full merits review scheme would be much more costly for these stakeholders. However, a full merits review scheme would provide end users with an ability to appeal decisions, although the costs of review may not enable them to do so in practice. Because less deference would be given to the decision maker who conducted the broad consultation on the decisions there would be a risk that service provider's views would prevail before the review body.

Regulator

The regulator may have to pay large costs when undergoing review. The introduction of a full merits review system will encourage regulators to take a lot more time and consideration into the decision-making process in order to deter future appeals, again increasing the costs to the regulator. This option would result in significantly greater costs and time delays placed on the regulator than would be imposed under any of the other options or in the absence of a review regime.

Governments

Governments would have to bear the costs imposed onto the regulators of the review scheme. Thus, this option would result in significantly greater costs placed on Governments than would be imposed under any of the other options or in the absence of a review regime

CONSULTATION

The Treasurer asked the Productivity Commission (PC) to examine current gas access arrangements on 13 June 2003. The inquiry involved wide industry consultation with a variety of groups, within, and related to, the gas industry, including pipeline owners and operators, gas users, industry associations, regulators and other government agencies. The Draft Report was released for public comment on 15 December 2003. A total of 50 submissions were received in response to the draft report and a number of modifications were subsequently incorporated into the final report. The final report was presented to the Government in June 2004.

The Review of Decision-Making in the Gas and Electricity Regulatory Frameworks Discussion Paper was released by the Ministerial Council on Energy's Standing Committee of Officials on 10 October 2005 for consultation with stakeholders on the scope of future review mechanisms within the NEL and proposed NGL. The paper called for comments from all stakeholders on the options and views presented to inform the development of policy actions by the MCE. Written submissions to the SCO closed on 7 November 2005 with a total of 26 submissions received. Submissions will be taken into account before any policy position is put to the MCE for decision.

This RIS is designed to encourage more consultation on the options suggested. Stakeholders do not need to reiterate all their comments on Options 2 and 3 when examining this RIS, as their concerns have been received via the submissions on the Discussion Paper.

IMPLEMENTATION AND REVIEW

Once the MCE's policy position has been finalised, any legislation necessary to give effect to that policy position will be developed. In the case of the gas regulatory framework, any legislative changes necessary will be included in the Exposure Draft of the National Gas Law (NGL) and the National Gas Rules to be prepared and released for public consultation in March-April 2006.

The MCE has policy oversight for the gas and electricity review schemes and will consider whether the review process adopted is adequate as it continues its reform progress over the next five years.

CONCLUSION

The MCE considers that either a modified merits review as outlined in Option 2 or only having a judicial review scheme as in Option 3, is the most appropriate way forward as these would most effectively address stakeholder concerns regarding timeliness, participation and cost while ensuring that there is no distortion of investment incentives. Both the status quo and *de novo* merits review options are not considered as sufficiently desirable alternatives.

Maintaining the status quo and continuing to rely on current review mechanisms in the gas and electricity markets would fail to address the distortion to investment that may be occurring as a result of the current review schemes. In addition, it is likely that this option would not facilitate an environment that is conducive to maximising the potential for future investment in the energy market.

De novo or full merits review is not considered a viable option given the lengthy consultation often involved in such economic regulatory decision-making. This option can arise in increased gaming possibilities and is very costly to all involved in the review proceedings. Thus, this option and a full merits review option are not considered to properly meet the Government's objective for an appropriate review scheme.

Stakeholder consultation is being used to inform the policy decision on the preferred way forward and stakeholders are not expected to resubmit their policy positions on the options which they have already submitted to the discussion paper.