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SUBMISSION TO MCE STANDING COMMITTEE OF OFFICIALS

By

TRANSMISSION NETWORK OWNERS

**REVIEW OF DECISION-MAKING IN THE
GAS AND ELECTRICITY REGULATORY FRAMEWORKS**

This submission is made jointly by the electricity transmission network owners ElectraNet, SP AusNet, Transend and TransGrid (the TNOs), in response to the MCE Standing Committee of Officials (SCO) discussion paper "Review of decision-making in the gas and electricity regulatory frameworks".

The TNOs are pleased to have the opportunity to contribute to the MCE / SCO considerations on this very important issue. Overall there appears to be a compelling public interest case for the merits review option to be available to electricity network businesses generally, and to electricity transmission businesses in particular.

Electricity networks represent vital public infrastructure delivering essential services. Understandably, the community has a very low tolerance of electricity network service failures, and is also concerned to ensure that reliable service comes at a reasonable price. This particularly applies to electricity transmission networks that underpin the reliable, secure, and efficient operation of the National Electricity Market. Poor quality regulatory decisions in relation to these services may place these outcomes at risk.

From a transmission business perspective, access to merits review provides assurance that correct and consistent regulatory decisions are made. It is not sufficient that regulatory decisions are lawful, if, at the same time, they are demonstrably wrong, create uncertainty, impair investment, and result in poor business performance and service outcomes. Access to merits review will ensure that regulators are fully accountable for their decisions, and provide adequate assurance of high quality regulatory decisions.

The current round of reforms of the regulatory framework provide a rare opportunity to set in place arrangements that deliver improved regulatory accountability, certainty to investors, and high quality regulatory decisions.

In coming to this position the legal operation of the various appeals mechanisms is crucial. Many of the factors to be considered in analysing options for appeals mechanisms are of a legal nature. The TNOs have therefore sought legal analysis on the most appropriate review mechanism, having particular regard to the alternative models proposed in the SCO discussion paper. This legal analysis, provided by Gilbert and Tobin, considers the issues from a public policy perspective and is appended as an integral and substantive component of our submission.

In addition, the following specific comments are offered in relation to the SCO discussion paper.

Importance of Access to an Appropriate Review Mechanism

The TNOs agree with the authors of the discussion paper that merits review is:

- a means to ensure accountability for regulatory decision-making; and
- one element of the broader regulatory framework necessary to produce transparent, fair and reasonable decision-making and economically efficient outcomes (paragraph 1.7).

However, for the electricity transmission sector, access to an appropriate review mechanism carries particular importance. This is on account of the following features of the electricity transmission sector:

- electricity transmission is highly regulated, such that network revenues are almost wholly set by regulatory decisions. The nature of transmission networks is such that this is more likely to remain the regulatory paradigm than for other sectors;
- the provision of transmission services is highly capital intensive. Access to an effective review mechanism would facilitate greater investor confidence and encourage the substantial and necessary investment in the sector; and

- transmission investments typically have extremely long useful lives, and are therefore dependent upon, and vulnerable to, recurring regulatory revenue decisions over a long period.

Various reviews into Australian competition and regulatory frameworks have found that access to effective review mechanisms is a key feature of the regulatory framework. For example the report of the Hilmer Committee stressed that unless basic established rights (in the nature of merits review) are treated in a circumspect manner under regulation, incentives for investment will diminish over time¹. The NCC took a similar position in reporting on its assessment of the draft National Third Party Access Regime for Natural Gas Pipeline Systems, which recommended on the establishment of GPAC², and the Productivity Commission highlighted the importance of effective review mechanisms in its review of the Gas Access Regime³.

Effectiveness of the Review Mechanism

The SCO discussion paper identifies criteria relevant to the development of an appropriate review scheme. These outcome “objectives” serve as a key reference in assessing the effectiveness of alternative review mechanisms. They include the following:

- maximising accountability;
- maximising regulatory certainty;
- maximising the conditions for the regulator to make the correct initial decision;
- ensuring the best decisions possible; and
- ensuring that all stakeholders’ interests are taken into account, including those of service and network providers, and consumers.

¹ Hilmer Committee (1993, p. 242)

² National Competition Commission, Recommendation to Gas Reform Implementation Group on the National Third Party Access Regime for Natural Gas Pipeline Systems (1997, p. 5)

³ Productivity Commission, Review of the Gas Access Regime 2004, Report no.31, Canberra, recommendation 11.4, p.499.

Accordingly, the TNOs would agree that the review mechanism established as a feature of the regulatory regime should be the mechanism that is most effectively able to achieve these important objectives.

Form of Review Mechanism

The two options for a review mechanism presented in the discussion paper sit within a whole spectrum of approaches that are available for consideration, and are not mutually exclusive. For example, “full” merits review has wide application in Australian regulatory regimes. In considering the full range of options the TNOs note that there are many arguments that could lead to the conclusion that “full” merits review is superior to the “limited” merits review of Option A in achieving the particular criteria noted above. However, the TNOs recognise that other criteria may have ruled against the “full” merits review option, and we do not propose to argue for consideration of such an option in this response.

Having regard to the two options presented, therefore, the very clear view of the TNOs is that Model A, merits review, is significantly superior to Model B, judicial review, in its effectiveness as a review mechanism. Further, as noted by Gilbert and Tobin in their analysis, judicial and merits review do not provide alternative pathways to accountability, but represent fundamentally different forms of accountability. They observe that, whether expressed in the form of Model B or otherwise, judicial review is only concerned with the lawfulness of the making of a decision. Merits review is concerned with the correctness of the substance of a decision (refer attached legal advice).

Notwithstanding the recent enhancement to energy law provisions to give direction to the AER in respect of the substantive aspects of making a transmission determination, the TNOs consider that these fall well short of the level of detail necessary to place due accountability on the AER. Nor is there any certainty that the AEMC review of Rules for Transmission Revenues and Pricing will produce additional sufficiently detailed provisions, and in any case, the level of detail that may be necessary could erode desirable flexibility within the regulatory regime associated with the AER’s ability to exercise appropriate discretion.

Each of the regulatory framework reviews referenced earlier in this submission, under the heading “Importance of Access to an Effective Review Mechanism”,

recommended merits review as a feature necessary to provide regulatory accountability. The NCC⁴ for instance, stated:

Many submissions raised concerns as to the broad powers and discretion of the regulator under the National Gas Access Regime – in particular, the regulator’s discretion to accept or reject any item in an access arrangement – or to impose one – and the implications for property rights and investment. It was widely argued that such powers necessitate an independent accountability mechanism to ensure that due process is followed. Such a mechanism would be a right to merits appeal.

The Council’s view is that a merits-based appeals mechanism on a regulator’s decision to impose an access arrangement would be in accord with principles of natural justice, due process and accountability, given the potential for the regulator’s powers in this matter to influence a service provider’s property rights and financial position.

The TNOs recognise that the NEL provisions on which Model B is based exist in any case for electricity transmission. However, we do not view Model B as an alternative to Model A but as complementary. The presence of a robust judicial review mechanism remains necessary to ensure accountability for procedural and legal aspects of the AER’s obligations in making regulatory decisions.

The attached legal analysis by Gilbert and Tobin has also considered the relative effectiveness of the options against each of the criteria established in the SCO discussion paper, and for each of these has confirmed that Model A is superior.

In addition, Gilbert and Tobin considered a further criterion identified by the authors of the discussion paper, “minimising the risk of gaming”, and discuss measures, including those proposed for Model A by the authors of the discussion paper, that can be included in the design of a merits review scheme to mitigate concerns on this account. We ask that these measures, and the supporting analysis, be given due consideration in arriving at a policy position.

⁴ National Competition Commission, Recommendation to Gas Reform Implementation Group on the National Third Party Access Regime for Natural Gas Pipeline Systems (1997)

Grounds of Review

The grounds upon which a Model A appeal may be heard determine the aspects of decision-making for which accountability will be heightened by the review mechanism. Having regard to the fundamental importance of the appealable grounds there are several observations we wish to make.

We note that the proposed grounds are similar to those set out for the appeal mechanism in the existing Gas Pipelines Access Law, with two main exceptions, as follows:

- We understand that the SCO is considering altering the second ground such that the regulator's exercise of discretion, where incorrect, must also be manifestly unreasonable. The TNOs consider that this change would be inconsistent with achieving any of the criteria noted in the discussion paper for an effective review mechanism. Rather, the proposed alteration works against the delivery of regulatory accountability and good decision-making, reducing the effectiveness of Model A merits review further in comparison to "full" merits review. We strongly urge the SCO to reject this alternative ground.
- We note that the SCO is proposing not to include the third ground, "that the occasion for the exercise of the discretion did not arise". We can understand the reasoning of the authors of the discussion paper, that this ground can be pursued under judicial review. However, the TNOs believe that inclusion of this ground for Model A merits review should not be precluded, especially in recognition of the fact that an appeal application may be made on more than one ground. In that event, the current proposal would require the service provider to lodge separate appeals with two bodies. This would be inconsistent with maintaining simplicity in the process and the criteria of minimising costs. We urge the SCO to retain the third ground of appeal.

Another matter relevant to this section is clarification of the scope of the AER's decision that is subject to accountability under the review mechanism. The scope in relation to electricity, as presented in Question 2(a) of the discussion paper is in respect of "the AER's determinations on revenue caps for transmission network

services, and ultimately distribution network services...”. The TNOs seek clarification in the terms for the scheme that this description includes not only the revenue component, but also the basket of services subject to the revenue determination.

Concluding Remarks

The vital nature of electricity transmission services to the community, and the significant role played by regulatory decisions in the efficient and effective functioning of electricity transmission businesses, dictate the need for high quality, accountable, regulation. In this regard access to an effective merits review mechanism, similar to Model A, is at least as important for electricity transmission as the Hilmer Review, the NCC and the Productivity Commission have concluded in relation to network businesses generally. The attached analysis by Gilbert and Tobin also clearly supports this conclusion from a public policy perspective.

The TNOs would welcome the opportunity to meet with officials to elaborate on our submission and discuss any other aspects of interest to the SCO.