

Business
Council of
Australia



SUBMISSION

Review of Limited Merits Review Regime

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The Business Council of Australia is a forum for the chief executives of Australia's largest companies to promote economic and social progress in the national interest.

About this submission

This is the Business Council's submission to the COAG Energy Council's (Energy Council) review of the Limited Merits Review (LMR) framework in the National Electricity Law (NEL) and the National Gas Law (NGL).

The COAG Energy Council is required to undertake this review as a result of reforms to the LMR framework in 2013. Specifically, the Energy Council was required to initiate a review of the Australian Competition Tribunal's (Tribunal) role under the amended legislative regime by December 2016.

The consultation paper released by the Energy Council to initiate this review identifies the following four potential reform options:

1. Retain the Tribunal as the review body without legislative amendment (status quo).
2. Retain the Tribunal as the review body with legislative amendments.
3. Replace the role of the Tribunal with a new investigatory body.
4. Remove access to LMR.

The Business Council considers the LMR regime to be an essential element of Australia's energy regulatory framework that provides an important safeguard against error in regulatory decision making. The Business Council recommends that the LMR regime and the Tribunal's review role are retained. If the Energy Council decides to introduce legislative amendments to the LMR regime (option 2), the Business Council believes that any amendments should be well targeted, proportionate and subject to further industry consultation.

The Business Council is strongly opposed to reform option 4. The Business Council also believes that replacing the Tribunal with a new investigatory body (option 3) is an unnecessary change that will create significant investor uncertainty, without achieving any discernible benefit.

Key recommendations

- Regulatory errors will occur no matter how competent or effective a regulator. These regulatory errors have the potential to be very damaging and measures should be put in place to allow for the correction of serious regulatory errors.
- The LMR regime is an essential element of Australia's energy regulatory framework that provides an important safeguard against regulatory error in decision making.
- Judicial review is not an effective substitute for the LMR regime. When looking at a request for judicial review, the Federal Court looks at a very different range of issues than what the Tribunal looks at under the current LMR regime.
- Where a policy decision is being made by an independent authority, the decision maker is not accountable to parliament. It is therefore considered best practice in such circumstances, that a robust merits review process is available to affected stakeholders.

- While changes to the current LMR regime may be necessary, policymakers must be cognisant of the risk that wholesale changes could create investor uncertainty and this could hinder network investment.

Key issues

The role of LMR is to correct regulatory errors

When considering potential reforms to the LMR regime, it is important to remember the rationale for the introduction of merits review in the energy sector was to correct for regulatory error in decision making. In 2006, the Ministerial Council of Energy stated that the LMR regime was intended to:

facilitate the correction of a range of regulatory errors with significant adverse consequences, encourage the making of the best administrative decisions in all circumstances and encourage investment in gas and electricity and across those sectors by promoting confidence in the regulatory process.¹

Ten years later, the Business Council believes that the importance of the LMR regime remains just as relevant in 2016.

Under section 71C of the NEL, the limited grounds for pursuing merits review is confined to whether the regulator's decision involved an error of fact, an incorrect exercise of discretion or an unreasonable decision having regard to all the circumstances. This means that if the LMR regime was removed and the Australian Energy Regulator (AER) makes a significant factual error, there would be no avenue for affected parties to seek a merits review of an erroneous regulatory decision.

Regulatory errors do occur and this is not a reflection on the competence of Australia's regulators. Rather, regulatory errors reflect the complexity of the analysis that must be carried out, the amount of regulatory discretion available (this point is discussed in more detail further below) and the wide variety of legitimate economic arguments that can be raised by affected parties.

Regulatory errors can be very damaging

Regulatory errors can be damaging to both network service providers and energy users. Serious errors in regulatory decisions can result in inappropriate price signals and distort investment decisions. Considering the importance of the energy sector to downstream industries, material regulatory errors in the energy sector have severe repercussions for the efficient functioning of the broader economy.²

The Business Council therefore contends that the harm caused by the removal of access to the LMR regime would go beyond the immediate and direct consequences of allowing erroneous regulatory decisions to go uncorrected.

¹ Ministerial Council on Energy, *Review of Decision-Making in the Gas and Electricity Regulatory Frameworks*, May 2006, p. 3.

² Professor Allan Fels AO, *The Merits Review Provisions in the Australian Energy Laws*, March 2012, p. 26.

Removing access to the LMR regime would also generally undermine confidence in Australia's regulatory framework, which would have a chilling effect on energy network investment in Australia. Such an outcome would be highly detrimental to the long-term interests of energy customers and contrary to the objectives of Australia's energy policy framework.

Regulatory discretion requires access to merits review

In 2012, the Australian Energy Market Commission (AEMC) introduced rule changes that increased the regulatory discretion available to the AER. The increased discretion related to how the AER determined the revenue allowance for regulated electricity and gas transmission and distribution services. This expanded discretion was found by the AEMC to be desirable because it:

... provides the regulator with sufficient discretion on the methodology for estimating the required return on equity and debt components but also requires the consideration of a range of estimation methods, financial models, market data and other information ...³

But increased regulatory discretion also provides more scope for legitimate areas of disagreement to arise and for factual errors to be made. For instance, when explaining the benefits of this increased regulatory discretion in 2012, the AER specifically noted that the important supervisory role that the LMR regime would have in protecting the rights of network service providers (NSPs):

The close ex post supervision that applies to the AER's decisions, from both judicial and merits review, significantly diminishes the risk that the NSPs would not be afforded a reasonable opportunity to recover at least their efficient costs, as required by the Law.⁴

Therefore, the AER itself recognised that access to the LMR regime would act as an important check on its expanded regulatory discretion. The Business Council believes it is particularly necessary that, in an environment where regulators are afforded a broad discretion, affected parties have access to a robust merits review system.

Judicial review is not an effective replacement to merits review

In discussing the option to remove access to the LMR regime, the consultation paper notes that affected stakeholders would still retain access to judicial review. However, it is very important to recognise that in no way does judicial review operate as an effective substitute for access to the LMR regime.

Judicial review is concerned with whether the regulator made an error of law. This means that when looking at a request for judicial review, the Federal Court looks at a very different range of issues than what the Tribunal looks at under the current LMR regime. If judicial review was the only appeal avenue left available to affected stakeholders, erroneous regulatory decisions (i.e. where the regulator has made a serious factual error, but not an error of law) could not be challenged under the right for judicial review.

³ AEMC 2012, *Economic Regulation of Network Service Providers, and Price and Revenue Regulation of Gas Services*, Final Position Paper, 29 November 2012, p. 8.

⁴ AER, *Economy Regulation of Network Service Providers: How do the Rules Constrain the AER*, May 2012, p. 7.

During the 2012 review of the LMR regime, Professor Allan Fels AO succinctly criticised the idea that judicial review could be used as an effective substitute for merits review:

Judicial review is directed at fundamentally different problems than merits review, and is not a cost-effective or accessible remedy for those seeking review of the AER's determinations. Judicial review would not be more accessible to user groups or consumer advocates than the existing merits review process.⁵

The Business Council agrees with this statement. If access to the LMR regime is removed, then the existence of judicial review would not address any of the concerns that have been identified in this submission, nor would it manage to improve the ability for user groups or consumer groups to participate in the review process.

It is also important to recognise the important role that merits review plays when decisions are being made by statutory authorities such as the AER. When a policy decision is made by a minister, merits review is not generally considered appropriate. This is because elected officials (the executive branch of government) are held to account by the parliament.

But statutory bodies such as the AER are delegated their authority by parliament and are not subject to the same parliamentary accountability. It has therefore been considered best practice for the decisions of statutory authorities to be subject to merits review.

This distinction was clearly articulated by the Productivity Commission in 2013:

The argument for limiting review rights to judicial review does not apply when the decision is made by a delegate (and the decision is not able to be reconsidered), or made by an independent body or an assessment manager, since these bodies are not elected officials and are not accountable to Parliament in a way that a Minister is.⁶

The Tribunal should be retained as the merits review body

The consultation paper has put forward the Office of the Australian Information Commissioner (OAIC) as an example of a 'fit-for-purpose body' that could be considered as a model for replacing the Tribunal. But as stated in the 'limitations' section for option 3 of the consultation paper, the Business Council agrees that replacing the Tribunal with a new investigatory body would be an 'untested approach for the energy sector. It would be complex to develop, expensive to implement, and could increase regulatory uncertainty'.

While it is important that the Tribunal performs its role in a timely and relatively predictable manner, the Business Council believes that in exercising its responsibilities over the past twelve years, the Tribunal has proved to be an effective merits review body.⁷

If the Energy Council believes that the Tribunal could operate more effectively (for example, by being less legalistic, more time-efficient and more inquisitorial), then making further improvements to the Tribunal's existing decision-making framework is the appropriate course of action. If reform of the existing LMR regime is to be carried out to address identified deficiencies with the Tribunal, this should be carried out following effective consultation with relevant stakeholders.

⁵ Professor Allan Fels AO, *op. cit.*, p. 3.

⁶ Productivity Commission Research Report. Major Project Development Assessment Process, November 2013, p. 266.

⁷ Business Council of Australia submission, *Competition Policy Review Draft Report*, November 2014, p. 34.

Conclusion

The Business Council supports the Energy Council's desire to ensure the LMR regime is working as effectively as possible. However, as explained in this submission, the Business Council believes a key component of Australia's energy regulatory framework must remain the ability for affected stakeholders to seek a merits review of erroneous regulatory decisions.

Access to merits review is the cornerstone of an accountable, transparent and efficient regulatory regime. The removal or further restriction of the LMR regime in the energy sector, without corresponding limits on the discretion of the AER, would only serve to undermine investor confidence and could lead to unaccountable regulatory decisions, which would lead to inefficient outcomes for investors and consumers.

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