



**EnergyAustralia**

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## Review of the Limited Merits Review Regime – Consultation Paper

### 1. Introduction

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EnergyAustralia welcomes the opportunity to comment on the COAG Energy Council's (the Council) Review of the Limited Merits Review (LMR) Regime.

We are one of Australia's largest energy companies, with over 2.5 million household and business customer accounts in NSW, Victoria, Queensland, South Australia and the Australian Capital Territory. We also own and operate a multi-billion dollar portfolio of energy generation facilities across Australia, including coal, gas and wind assets with control of over 4,500MW of generation in the National Electricity Market.

We have had little direct involvement in network revenue determinations and current LMR arrangements. However, our strong interest in this issue reflects the direct impact of the regulatory framework for network revenue determinations on our customers. This occurs through the direct contribution to their bills – with network costs accounting for between 40% and 50% of retail bills in some jurisdictions – and a more general uncertainty about pricing.

As an example, the lengthy LMR and subsequent Federal Court case about the Australian Energy Regulator's (AER) network revenue determinations in NSW has created considerable uncertainty for us and for our customers. The AER negotiated an outcome with the networks for their 2016/17 annual tariffs and we received limited advance notification of this decision. We have previously argued that insufficient notice to retailers of changes in network prices can have a detrimental customer impact.<sup>1</sup>

Moreover, we are concerned about the impact on customers of any substantial revenue adjustment that might occur following completion of the court case. In our experience, customers object to large swings in their bills (whatever the driver) from one year to the next and we see the potential in this case for a substantial adjustment and consequential impact on customer bills once a revised determination is made. This increases the possibility of bill shock and payment difficulties.

More fundamentally, we are concerned about the longer term customer impact of flawed regulatory settings, i.e. regulatory outcomes that are not consistent with the National Electricity Objective (NEO). Customers may pay too much for network services or alternatively, networks may not recover sufficient revenue to cover the efficient cost of safe and reliable

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<sup>1</sup> See EnergyAustralia's submissions to the AEMC's review of Distribution Network Pricing Arrangements (ERC0161), available at <http://www.aemc.gov.au/Rule-Changes/Distribution-Network-Pricing-Arrangements>

network services. In recent years, it seems the former may be the case, particularly as the NSW networks have referred to a degree of excess capacity across their networks during the development of their cost-reflective tariffs under revised pricing rules.<sup>2</sup>

## 2. LMR policy intent

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EnergyAustralia supports the stated policy intent of the LMR framework, restated in the Consultation Paper:

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

In our view, the current arrangements do not appear to be consistent with this policy intent. The Consultation Paper refers to numerous issues with the current framework. This includes the absence of any noticeable reduction in the number of appeals, the large volume of information that the Tribunal is required to consider, its legalistic nature and the difficulty for many stakeholders (including customers and their representatives) to engage with the LMR process and to understand the reasons behind Tribunal decisions. We share these concerns

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<sup>2</sup> See Endeavour Energy (2015), Tariff Structure Statement, page 19 for a specific example (available at <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/pricing-proposals-tariffs>)

and also note our earlier comments about the disruption to retail pricing processes and to customers when there is uncertainty about network tariffs.

We suggest that firm conclusions about the deficiencies of the current model should be qualified to some degree as the Federal Court case is ongoing. The Court's findings will offer further useful insight to the Council about the operation of the LMR arrangements.

Even so, the current arrangements continue to create significant uncertainty for customers about network tariffs. The 2013 amendments appear to have done little to reduce the incentive for networks to appeal AER decisions; LMR does not appear to be a last resort. Therefore, we do not support Option 1, which is retention of the status quo

### **3. Observations on effectiveness of 2013 amendments**

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In our view, there may be numerous reasons for the observed number of appeals since the 2013 LMR amendments. Some of these are a function of the existence of LMR in its current form, while others seem to be a consequence of the revenue determination process (i.e. Chapter 6 of the National Electricity Rules).

We have observed the following:

- There do not appear to be appropriate incentives for networks to provide all the required information in a timely and useable format to the AER for the purpose of making the best decision. This results in information asymmetries about the efficient cost of network services, potentially leading to less preferable decisions. Additionally, there appear to be incentives for networks to provide large volumes of information towards the end of the determination process for the point of ensuring the information is on the record and available for the Tribunal to use in an appeal.
- The burden of proof on networks to make case for LMR may be too low. As the Consultation Paper notes, applicants for appeal are only required to justify their action on the basis that correcting the relevant error of fact or discretion would, *prima facie*, lead to a materially better outcome for consumers.
- The revenue determination process still appears adversarial. It remains a 'propose and respond' model with little effective engagement or negotiation throughout the determination. The presence of the ACT as the 'real decision maker' (through the LMR) seems to reinforce this adversarial approach.
- The extent of genuine engagement between networks and consumers, and therefore, how revenue proposals relate to the NEO/NGO is unclear and appears to be inconsistent across businesses.
- The NEO is open to many interpretations and depends on a stakeholder's particular view of customers' best interests. There are many outcomes of a determination process that could reasonably be considered consistent with the NEO. The Tribunal's interpretation of the NEO appears to have been more narrowly focussed on issues of economic efficiency, without necessarily taking into account broader issues utilised in the AER determination process.
- There may be limitations on the AER's capability to adequately assess revenue proposals within prescribed timeframes. This might be due to resourcing, a lack of

operational knowledge, reliance on consultants of varying quality, inadequate timeframes that are further degraded by time wasting tactics, or inadequate powers to compel networks to provide relevant information during the revenue determination process or any other time.

- The AER exercised new powers in the NSW revenue determinations – for benchmarking the relative efficiency of networks – so it is not unreasonable for this to be the subject of review by the ACT.

The prevalence of LMR requests since the 2013 amendments is likely some combination of these factors. It is therefore difficult for us to make a clear judgement about the root cause(s) without further detailed analysis, particularly in advance of the Federal Court decision. Furthermore, we acknowledge that the 2013 amendments have only been in place for a short period and there is limited practical experience with them.

The Council should seek to better understand the reasons for observed outcomes factors and focus on the current policy objectives for the LMR regime in the short term. It could then consider the outcome of the Court case and whether it suggests more fundamental changes are necessary.

#### **4. Preferred option (Option 2)**

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EnergyAustralia does not support Option 3. We consider that establishing a new investigative body to provide review of the AER's determinations would add substantial costs and would in effect be a duplicate body to the AER. Setting up this new body would include developing the appropriate body of experts necessary to provide robust oversight of the AER and setting up the appropriate secretariat functions to support them. It is unclear if appropriate experts could be retained to provide a more correct interpretation of the AERs determination in line with the NEO/NGO. Many of the current incentives relating to the AER not being viewed as the final arbiter would also remain. Additionally, judicial review would still exist and thus even decisions of this new body would not necessarily be final. For these reasons we don't see sufficient benefits at this time to switch to a new investigative body.

EnergyAustralia continues to support LMR in principle as it offers a constraint on regulatory discretion and a mechanism for correcting obvious errors. Removal (Option 4) means reliance on judicial review, which is potentially more legalistic and time consuming than the current LMR process. Furthermore, it may give the networks grounds to argue for a higher regulated cost of capital if future revenue streams were considered to be riskier. At this time we consider that amending the current LMR process to better meet the original policy intent is the more preferable option. However, we also note that if the LMR regime is simply unable to meet the required policy intent (even with further amendments) then Option 4 should be revisited.

Our preferred option is to retain LMR with the Tribunal as the review body, albeit with some amendments. We recommend the Council consider the following as potential amendments, drawing on the outcome of LMRs since the 2013 amendments:

- Increasing the obligations on networks to make a case for LMR (the threshold for review) by strengthening the requirement to demonstrate that the AER's determination will not achieve the NEO. At present, the networks are only required to make a *prima facie* case that a different determination is 'likely' to lead to a materially better outcome for consumers.

- Improving the incentives and ease for the ACT to draw on any additional analysis of its own (including that of independent advisers it has engaged) to inform its decisions.
- Review membership of the ACT, including whether the presence of Federal Court judge locks in an adversarial, judicial approach as opposed to a more investigatory method.

However, LMR is only one element of the broader framework and we expect that observed outcomes are also a function of the revenue determination process. It is therefore equally important to create a strong incentive for networks and AER to reach an outcome through the determination process that is consistent with the NEO and for LMR to genuinely be a last resort.

We urge the Council not to limit its review to LMR alone, but to also consider potential amendments to Chapter 6 of the NER, including:

- Greater access for the AER to relevant information about network operations throughout the regulatory period, rather than in the context of a determination, to avoid inundation during the determination process.
- Ability for the AER to seek extensions – within reasons – to prescribed timeframes to consider or request information from networks.
- Revised requirements for networks to engage with customers with a view to ensuring revenue proposals are directly related to the NEO. This could be supported by customer focused metrics (possibly informed by the AER’s Consumer Challenge Panel) on which the networks report to the AER throughout regulatory periods. Alternatively, the ACT could look at how networks’ revenue proposals reflect customers’ needs when it decides whether to consider an appeal.
- Scope for the AER to develop binding guidelines outside the determination process (e.g. for calculation of WACC parameters) that then apply automatically to determinations, rather than being developed as part of individual determinations. These guidelines could be subject to LMR with any decision binding for the following determination cycle and with the determination process subject to Judicial Review.

In conclusion we consider that of the four options outlined in the Consultation Paper, Option 2 is preferred. We do not believe that the status quo is able to deliver the policy intent from the 2013 amendments. Option 3 is likely to impose significant costs on participants and consumers without adding significant improvements to the LMR process. We do not rule out supporting further exploration of the costs and benefits of Option 4, but we consider that a further amended LMR process is likely to deliver a better outcome overall at this time.

Should you require further information regarding this submission please call Geoff Hargreaves on (03) 8628 1479 or Chris Streets on (03) 8628 1393.

Yours sincerely

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