



3 October 2016

Limited Merits Review Project Team
C/o COAG Energy Council Secretariat
GPO Box 9839
Canberra 2601

Submitted by email to energycouncil@industry.gov.au

Dear Officials

Review of the Limited Merits Review Regime - Consultation Paper

Hastings Funds Management Limited (**Hastings**) is pleased to make a submission to the COAG Energy Council (**Council**) in relation to its assessment of the Limited Merits Review (**LMR**) framework as outlined in the consultation paper dated 6 September 2016 (**Consultation Paper**).

Hastings is a specialist global infrastructure debt and equity manager with a strong track record over its 22 year history. Hastings manages in excess of A\$10 billion in funds under management on behalf of a wide number of Australian and offshore institutional investors across a variety of sectors. With specific regards to regulated utilities, Hastings is one of the most experienced managers of electricity networks in the National Electricity Market with interests in ElectraNet and TransGrid. In addition we manage investments in the Sydney Desalination Plant (Australia), South East Water (United Kingdom) and Phoenix Natural Gas (United Kingdom).

In this submission we have focused on our role as an equity investor and deep experience with debt providers across a number of global markets. We recognise and support the views expressed by Infrastructure Partnerships Australia in their submission on behalf of the broader investment community, but would like to specifically note the following:

- **Certainty, stability and transparency** in the regulatory framework is a prerequisite for both equity and debt investor confidence, with investment decisions made with long term horizons in mind. The LMR is a fundamental pillar of this framework. We are concerned this critical aspect does not appear to be recognised in either the Consultation Paper or the review's terms of reference.
- **Maintaining "checks and balances" through an independent experienced body** such as the Australian Competition Tribunal (**Tribunal**) is essential to promoting high quality decisions and accountability of the regulator without political or external interference. This is not only critical for investors but provides an avenue for consumers' legitimate views to be heard.
- **Reduced appetite for investment by equity and debt providers** as the actual or perceived deterioration in the quality of the overall process negatively impacts equity appetite for future investment as well as the capacity and cost of debt from both domestic and foreign banks and institutions. Credit ratings agencies also place significant weight on the overall quality of the regulatory framework including the avenue for merits review¹. These three factors could all adversely impact a network's financing position which is highly relevant to the long-term interests of consumers.

¹ For example see Moodys' "*Australian Regulated Electricity and Gas Networks – 2017 Outlook*", 14 June 2016 "...The network's ability to contest the regulator's decisions evidences limits on the latter's [AER] level of discretionary power, which was conferred by a 2013 rule change, a factor that reinforces the transparency and predictability of the regulatory framework..."

- The erosion of real accountability of the regulator could create further adversariality and uncertainty in the process. Any increase in adversariality could potentially inhibit the collaboration desirable to foster maximum innovation such as developing and implementing optimal technology and operating solutions.
- LMR provides an opportunity to ensure factors are reasonably taken into account recognising the complex subject matter involved. This is even more important in a dynamic of increasing energy delivery choice where there is likely to be a broad range of complex views such as peak demand, remote monitoring and efficient maintenance practice to name a few.
- Hastings does not encourage appeals as a matter of course, only if we feel there is a real reason for decisions to be questioned in accordance with the National Electricity Law. In our experience the companies we invest in also consider the use of LMR only where it is legitimate and appropriate to do so, and not as a “default setting”.
- LMR is fundamentally different from judicial review and relying solely on the latter would be seen by investors as a fundamentally negative step change, since its focus is only that the correct process was followed, not that the materially preferable decision was made. Judicial review without LMR therefore appears inconsistent with the principles outlined in the Statement of Policy Intent dated December 2012.

When considering to invest in a regulated utility in Australia or globally we routinely spend considerable time assessing not only the written rules of the framework but also the existence of appropriate checks and balances between decision makers and evidence of accountability and focus on the quality of and predictability of decisions being made. There have been a number of instances where the absence of one or more of those factors caused us to withdraw from opportunities where in totality we did not have sufficient confidence on the robustness of the process.

Hastings regards a measured approach under Option 2 (retain Tribunal with amendment) as the optimal solution subject to the watching brief of Option 1 once the first review cycle is completed. We are supportive of well considered and appropriate modifications to the existing LMR process (but not material or wholesale changes) to the extent it promotes further confidence in the overall decision making process through fair access and more streamlined decision making and behaviour by all parties.

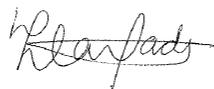
- *Hastings regards Option 1 (status quo) as a watching brief.* Given we have yet to see the first full cycle of the appeals process completed, it may be premature to rule out Option 1, although Hastings notes that Option 1 may be suboptimal compared to Option 2.
- *Hastings regards Option 3 (replace Tribunal with new body) as undesirable* as it could lead to practical difficulties and material cost at a premature stage and could raise doubts as to the fundamental principles of independence and accountability in the process.
- *Hastings strongly rejects Option 4 (removing access to LMR) as materially suboptimal and undesirable for long term investors.* The investment sector has relied on the LMR and its application through an independent Tribunal as a key investment characteristic for regulatory energy assets. Hastings believes that Option 2 provides flexibility to improve the process while maintaining long term certainty, stability and transparency in the process which will engender investment support.

Further details on our perspectives on each of the four options identified in the Consultation are attached to this letter. If you would like to discuss any matter raised in this submission, please do not hesitate to contact Ilan Sadeh on (02) 9287 8725.

Yours sincerely,



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Executive Director
Hastings Funds Management



Ilan Sadeh
Director
Hastings Funds Management

Appendix - Feedback on specific options

Option	Hastings' response	Key comments
Option 1 (status quo)	Too early to thoroughly dismiss, but likely not optimal	<ul style="list-style-type: none"> • Caution around confusing a "do nothing" approach versus a "wait until sufficient evidence". • If learnings can be identified to promote a real improvement in the process these should be fully explored.
Option 2 (retain tribunal with amendment)	Support	<ul style="list-style-type: none"> • For clarity this should be seen as improving the execution of the process, not changing the intent or principles underpinning LMR. • Areas for consideration could include reducing cost and perception of an overly formal/legal nature of proceedings; increasing access for all stakeholders which could include further funding support for key consumer groups; avoiding duplicative and unwarranted appeals; publishing substantive reasoning behind decisions. • May not require legislative changes to be implemented. • Any changes should be subject to extensive examination and input from subject matter experts using robust and defensible data.
Option 3 (replace tribunal with new body)	Reject	<ul style="list-style-type: none"> • We do not believe there is sufficient evidence that the Tribunal has not appropriately discharged its duties. • Creation of a new body may not solve real issues and could result in material cost to establish for little real benefit. • We have a significant concern this option could result in material changes to the underlying intent and application of LMR which we would be strongly opposed to.
Option 4 (remove access to LMR)	Strongly reject	<ul style="list-style-type: none"> • See reasons in submission paper. • In addition, the relatively high level of recent appeals should not lead to a conclusion that LMR is not working. Is it only reasonable to expect a level of testing through the appeal process given the introduction of fundamental changes to the determination processes in 2013 (as well as the high rate of successful appeals). • The level of review activity should diminish in periods where fundamental changes in regulatory practice are not being proposed.