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13/04/2018

Senior Committee of Officials
C/o COAG Energy Council Secretariat
GPO Box 787
Canberra ACT 2601

Lodged via email: energycouncil@environment.gov.au

Dear Officials,

Consultation on binding rate of return amendments

TransGrid welcomes the opportunity to respond to the COAG Energy Council's consultation on proposed binding rate of return amendments as set out in the draft Statutes Amendment (National Energy Laws) (Binding Rate of Return Instrument) Bill 2018.

TransGrid is the operator and manager of the high voltage transmission network connecting electricity generators, distributors and major end users in New South Wales and the Australian Capital Territory. TransGrid's network is also interconnected to Queensland and Victoria, and is instrumental to an electricity system that allows for interstate energy trading supporting the delivery of lowest-cost generation to consumers across the National Electricity Market (NEM).

TransGrid understands that the draft Bill does not represent government policy and it has not been endorsed by the Energy Council or any government participating in the national process at this stage. We urge the Energy Council and its members to carefully review the proposed legislation and consider the consequences to consumers and businesses of this draft Bill. We also encourage the Energy Council to undertake detailed, ongoing and meaningful consultation on this important legislative change, including the policy rationale for this proposed reform.

The Bill as drafted is not in the long term interests of consumers, as it is likely to lead to a loss of confidence in the Australian regulatory environment, which would increase the cost of investment and therefore the cost of energy to consumers.

There are four key concerns with the draft Bill:

1. It **removes most grounds for judicial review** of a decision by the Australian Energy Regulator (AER). This is inconsistent with previous consultation on the removal of limited merits review and provides unconstrained discretion to the regulator with a lack of oversight on the appropriateness of their decisions.
2. It **removes the important role of the independent rule-maker** provided by the Australian Energy Market Commission (AEMC), which is inconsistent with the NEM governance framework.
3. It **does not include adequate accountability checks**, which would result in a lack of confidence and certainty for all stakeholders in the process undertaken by the AER.
4. There is **a lack of transparency and regulatory stability in the process**. A transparent and stable regulatory framework is important feature of a well-functioning regulatory environment.

These concerns are outlined in further detail in this letter. We have also contributed to the development of the submission by Energy Networks Australia and support the views in that submission.

Removal of limited merits review did not contemplate removal of judicial review

It appears that the draft Bill has the consequence of further limiting the grounds available to a person seeking judicial review of a decision by the AER. The limited nature of the judicial review available for the rate of return instrument under the draft Bill is inconsistent with the basis on which the abolition of LMR was undertaken.

During the LMR reform consultation undertaken by the Senior Committee of Officials, consideration of the abolition of LMR was one of four options for reform of the LMR regime. This option was only considered and presented on the basis that judicial review would continue to be available for decisions of the AER (including on rate of return issues). For example (emphasis added):

> *Option 4: Remove access to LMR*
>
> *This option would remove access to LMR.* ***Affected stakeholders would retain access to judicial review****.*
>
> *Judicial review is not the re-hearing of the merits of a particular case. Rather, the court reviews a decision to make sure that the decision maker applied the relevant law correctly and reached a decision that was within jurisdiction, not unreasonable in the final result and arrived at by following the correct legal procedures.*[1]

Importantly, none of the four options contemplated by the Senior Committee of Officials involved the removal of both LMR of the AER's determinations generally and judicial review of the AER's determinations on the rate of return, which is the effect of this draft Bill. That is, the policy options were presented on the basis that either some form of LMR (whether the then status quo or some variant) or judicial review would apply to the determinations of the AER generally and on the rate of return.

This is further reinforced by the in-principle agreement of the COAG Energy Council to reform the LMR arrangements (there having been no consensus around the need for LMR to be abolished), which included as set out in the relevant COAG Energy Council Meeting Communique:

> *Introduction of a binding rate-of-return guideline, with relevant elements of the regulator's decision not subject to merits review*[2]

There is no reference to the removal of judicial review of the rate of return guideline or instrument in the Communique. This indicates that, consistent with the consultation undertaken by the Senior Committee of Officials, judicial review was intended to continue to be available for the binding rate of return guideline or instrument.

The introduction materials for the *Competition and Consumer Amendment (Abolition of Limited Merits Review) Bill 2017 (Cth)* (LMR Abolition Bill) also did not contemplate the removal of judicial review for the binding rate of return guideline or the rate of return aspects of an AER determination.

In particular, paragraph 1.18 of the Explanatory Memorandum for the LMR Abolition Bill states (emphasis added):

> New section 44AIA ensures that AER decisions made under the national energy laws are not subject to merits review by any State or Territory body. **A person's right to seek judicial review of an AER decision is unaffected** [Schedule 1, item 3, subsection 44ZZM(1) of the CCA].

Review processes are a common feature of regulated sectors as they provide an important check and balance in the regulatory framework. They provide confidence that regulators make good decisions the first time and any short-comings in regulatory decisions are addressed promptly. If removed, it provides regulators with unconstrained discretion with no oversight on the appropriateness of their decisions.

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[1] COAG Energy Council (2016), *Review of the Limited Merits Review Regime: Consultation Paper*, 6 September 2016, p.17

[2] COAG Energy Council (2016), *Meeting Communique*,16 December 2016 Meeting, p.2

Adoption of the Bill as drafted would result in the energy sector in Australia being a significant outlier when compared with the regulatory regimes of other utility sectors, both within Australia and internationally. No other Federal regulatory regime in Australia has effectively removed judicial review of rate of return issues. We are also not aware of any country with a similar regulatory background to Australia that has limited the scope of potential review in the manner contemplated by the draft Bill.

Accordingly, Australia will be a significant outlier when compared with the regulatory regimes of utilities internationally. In our view, this is likely to lead to a loss of confidence in the Australian regulatory environment by both domestic and international investors, and ultimately result in higher prices for consumers than if a judicial review mechanism is retained.

The role of the AEMC is an important feature of the NEM governance framework

The proposed amendments to Schedule 1 of the National Electricity Law (and the National Gas Law) delete the rate of return on assets as a subject matter for the National Electricity Rules (and National Gas Rules). The result of this deletion is that the AEMC would not have the power to make rules about the rate of return on assets. Instead, the draft Bill would replace the existing transparent rule making process with an AER process which appears to have less transparency and fewer opportunities for public consultation.

Such an approach would be inconsistent with the roles assigned to the AER as regulator and the AEMC as the independent rule-making body.

The legislative changes also seek to remove the guidance provide in the Rules in relation to the determination of the rate of return. These Rules have been developed through a transparent and consultative process. The proposed changes remove the overarching principles and guidance from the Rules.

The consequence of significantly more discretion to the regulator without the guidance currently found in the Rules compounds the already heightened concerns of risk held by the investors in networks. This is likely to lead to a higher risk premium in financing costs due to the lack of any appeal or review mechanism in relation to the binding rate of return. This would mean, all other things being equal, consumers will end up paying higher costs for network services under the proposed model than if judicial review is retained.

TransGrid is of the view that the proposed amendments should not be made, and that the AEMC's rule making power and the guidance in the Rules should remain.

Changes to legislation and governance roles must have strong accountability checks

The proposed amendments remove guidance from the Rules, remove the role of the AEMC and remove most grounds for judicial review of the AER's decisions by the Federal Court. This provides discretion to the AER on binding the rate of return every four years without strong accountability checks.

In the draft Bill, the AER would have discretion as to the composition of a consumer reference group and an independent panel, and how it goes about seeking concurrent expert evidence. TransGrid is concerned that this would result in inadequate and weak accountability checks. The consequence of providing broad discretion to the AER is likely to be significantly heightened investor uncertainty, which will impact the risk premiums applied to financing costs.

The rate of return guideline should be robustly informed by the perspectives, experience and expertise of a wide range of stakeholders in a transparent process. If the draft Bill is to be pursued, TransGrid encourages the Energy Council to include robust accountability checks on the AER to ensure that stakeholders understand the process that the AER will undertake in developing the guideline and that stakeholders can participate in a meaningful way.

For example, the appointment of representatives to the consumer reference group and the independent panel needs to be based on a clear and transparent process of appointing experts with relevant experience who can demonstrate a lack of conflict of interest. This would provide all parties with comfort that the AER's process includes experts and representatives with relevant expertise who are not conflicted in their advice. This could be done by the AEMC, at the request of

the AER. Furthermore, the AER's process must include opportunities for meaningful consultation with the businesses and consumers that its decisions affect.

Regulatory stability is an important feature of a well-functioning energy market

Networks, by their nature as very large infrastructure businesses with assets that have long operating lives, are heavily dependent on investor capital. Regulatory certainty on the rate of return decision is therefore paramount to businesses being able to continue to access capital markets to secure sufficient and affordable finance for such capital-intensive and long-lived assets.

The rate of return is the single most significant element of a revenue decision for regulated utilities. Any proposed changes to the existing framework should be carefully considered and consulted on widely with a broad range of stakeholders. In TransGrid's view there is a significant risk that the legislation as presented is not in the long-term interest of consumers as it will lead to heightened perception of regulatory risk within capital markets which would affect the ability of a network business to access efficient debt and equity funding.

Ongoing and meaningful consultation on this important legislative change is critical

The Energy Council's Bulletin has noted that this draft Bill does not represent government policy and it has not been endorsed by the Energy Council or any government participating in the national process. We would encourage the Energy Council to prepare and consult on a paper which reflects its policy rationale in relation to this important issue.

We also understand that the Senior Committee of Officials is considering hosting a stakeholder consultation forum. We would encourage a forum to be held so that the policy rationale for this draft Bill can be discussed openly by all stakeholders. Given the significance of this issue, we encourage the Energy Council to consult broadly prior to any finalisation of the proposed legislative reforms.

If you would like to discuss this submission, please contact me on 02 9284 3715.

Yours faithfully

Caroline Taylor
Acting Executive Manager, Regulation