MERITS REVIEW OF REGULATORY DETERMINATIONS IN THE ECONOMIC REGULATION OF ENERGY UTILITY INFRASTRUCTURE

Sophie Li*

Merits review of the Australian Energy Regulator's regulatory determinations is limited to the grounds specified in energy legislation: material error(s) of fact, incorrect exercise of discretion, and unreasonableness. Recent amendments to this 'limited merits review' regime introduced the requirement for review applicants and the review body to each establish a 'materially preferable decision' with respect to the prescribed objectives of energy utility regulation. Under the revised regime, a decision found to be affected by one or more reviewable grounds of error must be affirmed if an alternative decision does not exist that is materially preferable on its merits. This paper submits that this reconstructed regime better advances the long-term interests of energy consumers and the objectives of energy utility regulation.

Background

The objective of energy utility regulation is to advance the public interest in the efficient investment in monopoly infrastructures by regulating the revenue that utility operators can recover from tariffs charged to consumers. This objective is prescribed in energy legislation as the National Electricity Objective (NEO) and the National Gas Objective (NGO) which, with the endpoint of 'efficiency investment' in mind, further promote the 'efficient operation and use of infrastructure services for the long term interests of consumers with respect to price, safety, reliability and security of supply' of gas and electricity, and, in addition, in the case of the NEO, 'with respect to the reliability, safety and security of the national electricity system'.[1]

The framework governing the regulation of domestic energy markets is the *Australian Energy Markets Agreement* (the Agreement), entered into in 2004 by the ministers for energy of the Commonwealth and of participating jurisdictions convened under the then Council of Australian Governments (COAG) Ministerial Council for Energy (now the Energy Council, and formerly the Standing Council on Energy and Resources). The Agreement established the Australian Energy Markets Commission as the body vested with powers to make determinations varying rules under the National Electricity Law (NEL) and the National Gas Law (NGL), and the Australian Energy Regulator (AER) as the national economic regulator of electricity and gas infrastructure. Also under the Agreement, South Australia (SA) is the lead legislating jurisdiction, enacting the NEL and the NGL as schedules to Acts of the SA Parliament[2] with the remaining participating jurisdictions legislating to adopt the NEL and NGL, and any subsequent amendments, as laws within their own jurisdictions.

The AER is a statutory body established under the *Competition and Consumer Act 2010* (Cth) and is vested with powers and functions under the NEL and the NGL to make regulatory determinations setting energy tariffs and utility operators' total allowable revenue.

* Former counsel to the Australian Energy Regulator. Any views expressed are my own.

The national electricity market, as regulated under the NEL, currently extends to all Australian States and Territories except Western Australia and the Northern Territory. Interconnected gas pipeline networks in all jurisdictions except Western Australia and Tasmania are regulated under the NGL.

The Limited Merits Review Regime

In 2008, amendments to the NEL and the NGL introduced the regime for the limited merits review of electricity and gas regulatory determinations. Under this regime, application to the Australian Competition Tribunal (the Tribunal) for review of a regulatory determination of the AER is limited to the following grounds[3]:

1) the making of an error of fact that was material to the making of the decision;
2) the making of more than one error of fact that, in combination, were material to the making of the decision;
3) an incorrect exercise of discretion having regard to all the circumstances; and
4) the decision was unreasonable having regard to all the circumstances.

A 'reviewable regulatory decision' under the NEL or a 'designated reviewable regulatory decision' under the NGL is a revenue or pricing determination of an utility operator's total allowable revenue for a regulatory period (of usually 5 years).[4] A reviewable decision can include other types of determinations, typically cost pass-through determinations on whether network operators are to pass onto energy consumers certain unanticipated expenditure or savings during a regulatory period.[5]

The SCER Inquiry

In 2012, the then COAG Standing Council on Energy and Resources commissioned a review (the SCER review) into the effectiveness of operation of limited merits review under the NEL and the NGL. The review found that limited merits review, during the first four years of the regime's operation, took an error-based approach to changing the distribution of economic resources between utility operators and energy consumers and, as a result, neglected the quintessential merits of the central pricing and revenue determination.[6] The scope of regulatory reviews was found to have been unduly narrow and the Tribunal, in considering those aspects of the decision relevant to the grounds of review, failed to have regard to the merits of the regulatory decision overall.[7] Reviews also paid insufficient attention to the objectives of energy utility regulation and the long-term interests of energy consumers, thereby failing the legislative intent.[8]

Revisions to the Regime

In November 2013, the NEL and the NGL were amended[9] to address the findings of the SCER review. The most important of these amendments was the introduction of this concept of a 'materially preferable decision' with respect to the NEO and the NGO as a tier to the review in addition to the grounds of review. The amendments require that:

1) an applicant for leave to appeal a reviewable regulatory decision establish a prima facie case that a determination made by the Tribunal to vary an AER decision or to set aside and remit a decision to the AER on the basis of one or more grounds raised in the application, either separately or collectively, would, or would be likely to, result in a materially preferable NEO or NGO decision; and
2) the Tribunal, in determining an appeal before it, be satisfied of the same – that is, that a decision that is materially preferable to the reviewable regulatory decision in

> making a contribution to the achievement of the NEO or the NGO will, or is likely to, result – before determining to vary or set aside and remit a decision.[10]

The Second Reading Speech to the amendment bill explains that the long-term interests of consumers is to be 'of paramount consideration' to the Tribunal's determination and that the position of Energy Ministers on the former Standing Council on Energy and Resources is that the interests of consumers should be 'the sole criterion' for determining the preferable decision.[11] In this legally fine-tuned regime, any reliance on such departures from or substitutes for the legislative language as 'paramount consideration' and 'sole criterion' is apt to mislead.

Post the 2013 amendments, an applicant for review must establish one or more of the grounds for review *and* a prima facie case for a 'materially preferable decision'. A Tribunal considering an appeal must affirm a decision, notwithstanding that the decision might be affected by an error of the reviewable type, if it is not satisfied that an alternate 'materially preferable decision' better promotes the objectives of energy utility regulation. The 2013 amendments promote a stay of the regulator's determination, or improve so-called 'regulatory certainty', by both lifting the threshold for the Tribunal to grant leave to appeal and increasing the applicant's burden of proving why a determination admitted on appeal should be anything but affirmed.

'Materially Preferable Decision'

The NEL and NGL guide proscriptively construction of the term 'materially preferable decision', that is, by reference to what one is not to do: impact on revenue is not to be, in and of itself, determinative of whether a 'materially preferable decision' exists; establishment of one or more ground(s) of error is not to be, in and of itself, so determinative; and the mere fact that the pecuniary interest the subject of appeal meets the legislative threshold ($5 million or 2% of revenue) for leave to be granted is also not to be so determinative.[12]

The Tribunal, in July 2015, granted the three NSW electricity distribution networks leave to appeal the AER's regulatory determinations applying to them for the 2014-19 regulatory period, admitting of their respective submissions a prima facie case that a variation or remit of the AER's decisions would be likely to result in materially preferable decisions.[13] At the time of this paper, the substantive outcomes of those appeals are not known. On the interpretation of the term 'materially preferable decision', the Tribunal concedes, in its reasons for granting all applicants' leave to appeal, that:

> the satisfaction required [of it in order to admit an appeal] may exist on the basis of one or more of the (accepted) grounds of review giving rise to that prima facie appearance to, or level of satisfaction to, the Tribunal. That is because, at this point, it would be very difficult, and certainly not efficient, to assess the inter-relationship between grounds of review in any comprehensive way.[14]

The Tribunal's reasoning suggests that interpretation of 'materially preferable decision', at the stage of determining an application for leave to appeal, admits of a type of higher-order subjective evaluation, one which foresees, and predicates the granting of leave on a 'prima facie appearance', of there being a 'materially preferable decision', by the making out of a ground of error. In making the substantive determination to an appeal so admitted, the Tribunal is to embark on a slightly different exercise, one which is to separate its evaluation of whether a 'materially preferable decision' exists from the fact of there being a reviewable ground of error, so that the latter alone does not determine a question of the former.[15]

ActewAGL's Appeal of a Cost Pass-through Determination

At the time of this paper, the Tribunal had dealt conclusively with one appeal of a reviewable regulatory decision under the revised limited merits review regime. In *Application by ActewAGL Distribution*[16]*,* the ACT electricity distribution network ActewAGL appealed a decision of the AER to reject its application to pass through to electricity consumers incremental cost increases, due to periods of increased rainfall in the ACT, to the clearing of vegetation growth around power lines (a component of the operating expenditure). The Tribunal held that the AER's decision to reject the application was merely a purported decision because it was made outside of the statutory timeframe and that, applying the relevant legislative provisions, the AER was therefore deemed to have accepted ActewAGL's cost pass through application. A deemed decision, the Tribunal continues, characterised by the lack of a published determination, may nevertheless be a 'reviewable regulatory decision', enabling 'an affected or interested person or body'[17] (which could be construed to encompass energy consumers individually and collectively), having standing under the NEL and the NGL, to appeal a decision so deemed.[18]

Implications for Administrative Justice

Merits review of energy utility regulation is, in addition to being limited to specified grounds and to those appeals to which the Tribunal grants leave, is limited also in the body of evidence which the review body could consider in an appeal and the matters which an applicant could raise on review.

The NEL and the NGL, properly construed, do not permit the Tribunal or the AER, as a party to a review, to broaden the scope of a review to encompass additional grounds.[19] The prohibition on the Tribunal of casting a wider view of the regulatory decision, beyond those elements of it alleged to be in error, made the pre-2013 regime vulnerable to inflated revenue. It enabled network operators to 'cherry-pick' particular building blocks of regulatory determinations for appeal with almost predictable success for their revenue bottom-line.[20]

While under the pre-2013 regime, the Tribunal *could* cast a wider view on the regulatory decision, and in fact needed to look at the overall regulatory decision and its complexities in determining whether to vary it or set it aside and remit it [21], the taking of that wider view was almost tokenistic, in that the review focus was still on error-correction. The SCER inquiry referred to this situation as a 'one way street'[22], that is, that the outcome of evaluating the overall regulatory decision was not a ground on which the Tribunal could reject an appeal of a decision affected by a ground of reviewable error. In practice, this meant that the mere fact that an operator's allowable revenue was sufficient or efficient was not, by itself, a basis on which the Tribunal could allow the corresponding regulatory determination to stand. While this was a legally sound paradigm for the operation of conventional merits review, that is, the correction of specified grounds of error, its policy outcome was the 'gold-plating' so-alleged of network infrastructure and ad-hoc network pricing influenced by 'cherry-picking' (one example of this is that approved tariffs charged by NSW electricity network operators were double that charged by Victorian network operators, though there are other contributing factors to this phenomenon).

The 2013 amendments opted for pragmatism in a shift away from conventional merits review. Under that regime, the establishment of a ground of review (or error) is only one half of the equation. If an alternative decision was not materially preferable, then the original decision must be affirmed notwithstanding that it is affected by one of the errors constituting the ground(s) for review.

Whilst this practice sits rather anomalously with established principles of administrative law, it achieves what legislators expect to be a more 'holistic'[23] approach to review of regulatory determinations, respecting the reality that elements of the building block model interrelate. One obvious example is the relationship of trade-off between operating expenditure and capital expenditure: a higher capital allowance for the replacement of ageing network assets usually correlates to a reduction to the operating expenditure needed to maintain those same assets.

Under the post-2013 regime, all constituent elements of the primary decision inform the formulation of the 'materially preferable decision' and, subsequently, the decision to affirm, vary, or set aside and remit a primary decision. While the scope of the review's remit appears to have broadened through the addition of an express legislative requirement to consider the decision as a whole in determining whether a materially preferable NEO or NGO decision exists[24], the revised regime actually does little to give consumers and network operators certainty of pricing or to add to the volume or extent of litigation. On the other hand the imposition of those caveats discussed above requiring an applicant to seek leave to appeal from the Tribunal, mean the original regulatory determination is more prone to being affirmed than it was under any previous regime.

The Tribunal must now state in its reasons for decision how the 'constituent components of the reviewable regulatory decision interrelate with each other and with the matters raised as a ground for review'[25], further entrenching the whole-of-decision approach to evaluating achievement of the NEO and the NGO and addressing shortcomings found to arise from applying the previous regime.

A further limitation of merits review under this regime, as with the pre-2013 regime, is that applicants for review must not raise any matter that was not raised in regulatory proposals and submissions to the regulator. Post-2013, applicants for review must have both 'raised and *maintained*' (emphasis added) a matter in submissions to the regulator in order to raise the matter on review.[26] The Tribunal could consider new extrinsic material if satisfied that that material was publicly available to the regulator, or not reasonably withheld from it, so as to give rise to a reasonable expectation that the regulator would have considered it in making its determination.[27]

Intersection with Judicial Review

Regulatory determinations appealed to the Australian Competition Tribunal have on occasions been appealed concurrently to the Federal Court. Despite the availability of this appeal avenue, the Federal Court had entertained less than a handful of applications.[28] This situation might change post-2013 (the NSW networks' concurrent appeals of 2015 to the Federal Court might be seen as evidence of this).

If an applicant seeking of the Tribunal leave to appeal were to fail to establish the requisite prima facie case for a 'materially preferable decision', then the applicant could find virtually identical grounds in judicial review for setting the decision aside. The four grounds of error for limited merits review are almost replicated in statutory judicial review. They are improper or incorrect exercise of discretion, unreasonableness, and lack of evidence or factual basis for decision;[29] and in common law judicial review for no evidence, and irrationality or illogicality. The demarcations known to exist between judicial and merits review have never been as fine as under the revised regime.

Despite its availability as an avenue of appeal, reliance on judicial review as a substitute for limited merits review can have the corollary of reversing the improvements to the regime which it is the intent of the 2013 revisions to implement. The essence of judicial review is

enforcing the rule of law against *ultra vires* exercises of power and, as it is not concerned primarily with arriving at a preferable decision on the merits, a decision invalidated in judicial review and corrected for any affected errors upon remit stands as a valid regulatory decision irrespective of considerations of merit. This is the sort of unilateral and error-correcting approach which the 2013 amendments sought to abolish for its failure to regard the merits of a decision as a whole and its neglect of the legislative policy intent. To ask of a court in judicial review to function as a merits body in this sphere is to 'entangle [judicial review] with policy making, creat[ing of] severe difficulties for judge-led organisations, since it requires judges not only to become policymakers, but also to explain and be accountable for decisions in ways that the regulator is'.[30]

Conclusion

The science of utility regulation in Australia, and in several other first-world countries, is in many ways unsophisticated. In this twenty-first century, and a decade following the convention federating domestic energy markets, regulation of Australia's domestic energy markets is continuing to unify and mature through the implementation of better regulation initiatives and sound application of the growing reserves of economic benchmarking data from both domestic and international sources.

The 2013 revisions make significant headway in advancing the objectives of regulation by purging the previous review regime of its critical weaknesses. Limited merits review, particularly post-2013, is becoming increasingly a regime designed to accommodate the peculiarities and complexities of any sort of review of utility regulatory determinations. By appearing to challenge the textbook separation of jurisdiction and merit, it becomes better positioned to effect regulatory objectives.

Endnotes

1 National Electricity Law (NEL) s7; National Gas Law (NGL) s23.
2 The NEL and the NGL are Schedules to the *National Electricity (South Australia) Act 1996* (SA) and the *National Gas (South Australia) Act 2008* (SA) respectively.
3 NEL s71C; NGL s246.
4 NEL s71A; NGL s244.
5 *National Electricity (South Australia) Regulations 1996* (SA), Reg 9, prescribing a 'reviewable regulatory decision'.
6 Yarrow, Egan and Tamblyn, 'Review of the Limited Merits Review Regime – Stage One Report', 29 June September 2012 ('Stage One Report'), available on the COAG Energy Council website: https://scer.govspace.gov.au.
7 Ibid.
8 Ibid.
9 *Statutes Amendment (National Electricity and Gas Laws – Limited Merits Review) Act 2013* (SA).
10 NEL ss71E, 71P; NGL ss248 and 259.
11 Second reading speech to the Statutes Amendment (National Electricity and Gas Laws – Limited Merits Review) Bill 2013, South Australian House of Assembly, 26 September 2013 ('Second Reading Speech').
12 NEL s71P(2b)(d), NGL s259(4b)(d).
13 *Applications by Public Interest Advocacy Centre Ltd, Ausgrid, Endeavour Energy and Essential Energy* [2015] *ACompT* 2 (17 July 2015).
14 Id at [19].
15 NEL s71P(2b)(d)(i); NGL s259(4b)(d)(i).
16 *ACompT* 2.
17 NEL s71B.
18 *Application by ActewAGL Distribution*, above n 18 at [29].
19 Opinion of the Acting Solicitor-General of the Commonwealth, No 22 of 2012, 'In the Matter of the Limited Merits Review Regime in the National Electricity Law and the National Gas Law', 12 September 2012 ('Solicitor-General Opinion'), available on the COAG Energy Council website: https://scer.govspace.gov.au.
20 Yarrow, Egan and Tamblyn, 'Review of the Limited Merits Review Regime – Stage Two Report', 30 September 2012 ('Stage Two Report'), at 31, available on the COAG Energy Council website: https://scer.govspace.gov.au.
21 Solicitor-General Opinion, above at n 22.

22 Stage One Report, above at n 7.
23 Second Reading Speech, above at n 13.
24 NEL s71P(2b)(d)(i); NGL s259(4b)(d)(i).
25 NEL s71P(2b); NGL s259(4b).
26 NEL s71O(2); NGL s258A(3).
27 NEL s71R(3); NGL s261(3a).
28 These have been in instances where applicants have commenced judicial review in strategic preference to merits review (for example, *ActewAGL Distribution v The Australian Energy Regulator* [2011] FCA 639) or initiated judicial review of a decision made by the Tribunal in merits review (for example, *SPI Electricity Pty Ltd v Australian Competition Tribunal* [2012] FCAFC 186).
29 *Administrative Decisions (Judicial Review) Act 1977* (Cth) ss5 and 6.
30 Stage Two Report, above at n 23.