

Chapter 1

Introduction

Referral

1.1 On 7 September 2017, the Senate referred the Competition and Consumer Amendment (Abolition of Limited Merits Review) Bill 2017 to the Senate Environment and Communications Legislation Committee (the committee) for inquiry and report by 16 October 2017.¹

Purpose of the bill

1.2 The bill seeks to amend the *Competition and Consumer Act 2010* (CCA) to prevent the Australian Competition Tribunal (the Tribunal) from reviewing certain decisions made under the national energy laws by the Australian Energy Regulator (AER) other than those relating to the disclosure of confidential or protected information. The bill also seeks to amend the CCA so that the merits of an AER decision cannot be reviewed by any other state or territory body.

Conduct of the inquiry

1.3 The committee advertised the inquiry on its website and wrote to relevant organisations inviting written submissions. The date for receipt of submissions was 19 September 2017.

1.4 The committee received 12 submissions which are listed at Appendix 1 of this report. The committee held a public hearing in Melbourne on 3 October 2017. The list of witnesses who gave evidence at the hearing is at Appendix 2.

1.5 The public submissions and *Hansard* transcript of the public hearing are available on the committee's website at: http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Environment_and_Communications/

1.6 The committee thanks all of the individuals and organisations that contributed to the inquiry.

Reports of other committees

1.7 When examining a bill or draft bill, the committee takes into account any relevant comments published by the Senate Standing Committee for the Scrutiny of Bills. The Scrutiny of Bills Committee assesses legislative proposals against a set of

1 *Journals of the Senate*, 2016–17, No. 59, 7 September 2017, pp. 1894–95.

accountability standards that focus on the effect of proposed legislation on individual rights, liberties and obligations, and on parliamentary propriety.

1.8 In its Scrutiny Digest No. 9 of 2017, the Scrutiny of Bills Committee stated that it had no comment on the bill.² The Parliamentary Joint Committee on Human Rights concluded that the bill did not raise human rights concerns.³

Structure of the report

1.9 This report comprises three chapters as follows:

- Chapter 1—provides background information and key provisions of the bill; and
- Chapter 2—discusses the issues raised in submissions and evidence received at the committee's public hearing in relation to the proposed changes and provides the committee's conclusions and recommendations.

Note on references

1.10 References to the committee *Hansard* transcript for the 3 October 2017 public hearing are to the proof transcript. Page numbers may vary between proof and official *Hansard* transcripts.

Background

1.11 In 2004, the Commonwealth, states and territories entered into the *Australian Energy Market Agreement* (AEMA). This agreement followed recognition by the Council of Australian Governments (COAG) that a nationally coordinated approach to regulating energy markets was more efficient than a fragmented state-based policy approach. This national cooperative approach was viewed by all jurisdictions as the most efficient framework to deliver improved economic and environmental benefits to a diverse range of communities—households, small business, industry, and in urban and regional areas.⁴

1.12 There are three key components to Australia's energy markets:

2 Senate Standing Committee for the Scrutiny of Bills, *Scrutiny Digest*, No. 9 of 2017, 16 August 2017, p. 6.

3 Parliamentary Joint Committee on Human Rights, *Scrutiny Report*, No. 9 of 2017, 5 September 2017, p. 1.

4 Council of Australian Governments (COAG) Energy Council, 'Australian Energy Market Agreement (as amended December 2013)', p. 1, 9 December 2013, COAG energy website, <http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/Australian%20Energy%20Market%20Agreement%20-%20Dec%202013.pdf> (Accessed on 27 September 2017.)

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- National Energy Market (NEM) is the wholesale electricity market for the connected states (Queensland, New South Wales, Victoria, Tasmania and South Australia) and the Australian Capital Territory;⁵
 - the domestic natural gas market;⁶ and
 - energy retail markets through which retailers sell electricity, gas and energy services to residential and business customers.

1.13 The national energy laws provide the framework for energy regulation. The national energy laws are comprised of the National Electricity Law (NEL), the National Gas Law (NGL) and the National Energy Retail Law (NERL).⁷ This is a state-based cooperative scheme with the laws as schedules to South Australian Acts. The laws apply as state and territory law by legislation in force in the states and territories which participate in the scheme. The Commonwealth *Australian Energy Market Act 2004* (AEM Act) applies the relevant energy laws to offshore areas as well as to certain territories.⁸

1.14 The NEM is governed by institutions established by COAG following the signing of the AEMA. The main institutions are:

- the COAG Energy Council, comprising of Ministers responsible for energy, which has responsibility for national policy and governance for the electricity and gas markets;
- the Australian Energy Market Commission (AEMC), which is responsible for rule making and market development of the electricity and natural gas markets;
- the AER, which is responsible for enforcing the rules for the NEM and for economic regulation of electricity and gas transmission networks and retail markets;

5 Queensland, New South Wales, Australian Capital Territory, Victoria, Tasmania and South Australia. Western Australia and the Northern Territory currently operate their own electricity markets, with Western Australia in the process of examining how it might enter the NEM. See Department of the Environment and Energy, 'Electricity market development', <http://www.environment.gov.au/energy/markets/electricity-market-development> (Accessed 27 September 2017.)

6 Eastern gas region, Western gas region, and Northern gas region. Unlike the NEM, there is no national wholesale market for gas. See AEMC, 'Natural gas markets', AEMC website <http://www.aemc.gov.au/Australias-Energy-Market/Markets-Overview/National-gas-market> (Accessed 27 September 2017.)

7 The NEL is in the schedule to the *National Electricity (South Australia) Act 1996*; the NGL, which regulates gas pipelines and gas wholesale markets, is in the schedule to the *National Gas (South Australia) Act 2008*; and the NERL, which regulates the supply and sale of energy to retail customers, is in the schedule to the *National Energy Retail Law (South Australia Act 2011)*.

8 Explanatory Memorandum, p. 4.

- the Australian Energy Market Operator (AEMO) operates the whole national electricity and gas markets and undertakes market development functions to maintain system security and safety; and
- Electricity Consumers Australia (ECA) promotes the long-term interests of consumers, particularly those of residential and small business customers. The ECA supports an effective competitive national market as the most efficient model to deliver benefits in the long-term interests of consumers.⁹

Australian Energy Regulator

1.15 The AER is a Commonwealth body established by section 44AE of the CCA. In addition to functions conferred on the AER by Commonwealth legislation, section 44AI provides Commonwealth consent to the conferral of functions on the AER under the state and territory versions of the national laws. Both the NEL and NGL confer functions and powers on the AER 'to set the prices that businesses may charge for, and the revenue they may earn from, the provision of electricity network services and access to covered pipelines'.¹⁰

1.16 In discharging its functions, the AER's work must be consistent with national energy (electricity and gas) objectives (NEO and NGO). The AER must:

...perform economic regulatory functions in a manner that is likely to contribute to the achievement of the national electricity and gas objectives. The objective is to promote efficient investment in, and efficient operation and use of, electricity/gas services for the long term interests of consumers of electricity with respect to price, quality, safety, reliability and security of supply of electricity/gas; and in the case of electricity the reliability, safety and security of the national electricity system.¹¹

1.17 The process by which the AER arrives at its revenue and access determinations is lengthy and involves extensive inquiry processes, analysis and consultation.¹²

Limited merits review of AER decisions

1.18 The limited merits review¹³ regime commenced in 2008 following amendment of the NEL and the NGL. The introduction of limited merits review was

9 Department of the Environment and Energy, 'Energy market institutions', <http://www.environment.gov.au/energy/markets/energy-market-institutions> (Accessed on 27 September 2017.)

10 Explanatory Memorandum, p. 4. In Western Australia, the state body Economic Regulation Authority (ERA) is the regulator.

11 Explanatory Memorandum, p. 4.

12 The process is outlined in the explanatory memorandum, pp. 5–6. See also Australian Energy Regulator, *Submission 3*, Attachment 2, Submission to the review of limited merits review framework, October 2016, pp. 4–6.

part of an attempt to balance outcomes between competing interests and protect the property rights of all stakeholders by allowing parties affected by decisions appropriate recourse to have decisions reviewed. In addition, policymakers 'intended that introducing LMR in the energy sector would enable correction of a greater range of regulatory errors and improve accountability in regulatory decision making'.¹⁴

1.19 Currently, an affected party or person, with leave of the Tribunal, may apply for review of certain AER decisions (referred to as 'reviewable regulatory decisions') made under the national energy laws. Reviewable regulatory decisions include:

- under the current version of the NEL: network revenue and pricing determinations, and determinations relating to approved and required pass through amounts;
- under the current version of the NGL: coverage decisions, decisions in relation to the making and revoking of light regulation determinations, access arrangement decisions, AER ring fencing determinations and exemptions, and decisions about the approval of associate contracts; and
- information disclosure decisions.¹⁵

1.20 Leave must not be granted unless there is a 'serious issue to be heard' and the applicant has established a prima facie case that one or more grounds would be likely to result in a materially preferable NGO or NEO decision. The grounds for review included that the regulator made an error(s) of fact, the exercise of the regulator's discretion was incorrect, and/or the decision was unreasonable, having regard to all the circumstances. The limited merits review regime also incorporates certain financial thresholds and other criteria that must be satisfied for a review to be undertaken. An applicant must also demonstrate how the Tribunal's determination would be, or would likely be, 'materially preferable' to the AER's decision.¹⁶

1.21 The Tribunal must make a determination which either affirms or varies the original decision, or sets the decision aside and remits the matter back to the AER to be remade in accordance with any direction or recommendation of the Tribunal. The Tribunal may only make, vary or remit the decision if it is satisfied that doing so is likely to result in a materially preferable NGO/NEO decision.¹⁷

13 Merits review is the process by which a person or body, other than the primary decision maker, reconsiders the facts, law and policy aspects of the original decision and determines the 'correct' or 'preferable' decision. COAG Energy Council, *Review of the Limited Merits Review Regime Consultation Paper*, September 2016, p. 6.

14 COAG Energy Council, *Review of the Limited Merits Review Regime Consultation Paper*, 6 September 2016, p. 7.

15 Explanatory Memorandum, p. 9.

16 Explanatory Memorandum, p. 6; AER, *Submission 3*, Attachment 2, p. 8.

17 Explanatory Memorandum, p. 6.

1.22 Affected parties may also seek judicial review of administrative decisions.¹⁸

Reviews of limited merits review

1.23 The limited merits review regime has been reviewed twice. The first review was undertaken in 2012 by an independent panel led by Professor George Yarrow on behalf of the then COAG Standing Council on Energy and Resources, following the Tribunal's decisions between 2009 and 2011 which led to significantly higher retail electricity prices.

1.24 While finding that the original policy intention for introducing a regime 'remained sound and relevant', a number of shortcomings were identified including that it had not delivered on that intention. In addition, the review identified that the limited merits review regime did not adequately address all stakeholders' interests (especially consumers), was excessively legalistic in its approach, and was costlier, with cases taking longer than anticipated.¹⁹

1.25 The COAG Standing Council on Energy and Resources agreed to retain the limited merits review regime but introduced amendments in 2013 to:

...ensure that regulatory decisions promote efficient investment, operation and use of energy infrastructure in ways that best serve the long-term interests of consumers. This included avoiding lengthy and excessively legalistic hearings that make it difficult for all stakeholders to participate.²⁰

1.26 The amendments included:

- raising the threshold for seeking merits review;
- ensuring determinations were in the long-term interests of consumers; and
- increasing the participation of consumers.²¹

1.27 Following the 2013 amendments, 12 of the 20 decisions on electricity network revenue and gas access arrangements were subject to applications by network businesses for review by the Tribunal. The affected businesses involved had sought a total of around \$7.3 billion in additional revenue.²²

18 Judicial review 'only allows for a review of the legality of earlier decision making processes'. It usually consists of a review of the procedures undertaken to make a decision. COAG Energy Council, *Review of the Limited Merits Review Regime Consultation Paper*, September 2016, p. 6.

19 COAG Energy Council, *Review of the Limited Merits Review Regime Consultation Paper*, 6 September 2016, pp. 4, 8–9.

20 COAG Energy Council, *Review of the Limited Merits Review Regime Consultation Paper*, 6 September 2016, p. 4.

21 COAG Energy Council, *Review of the Limited Merits Review Regime Consultation Paper*, 6 September 2016, p. 9.

22 Explanatory Memorandum, p. 6.

1.28 As a consequence of continued concerns with the limited merits review regime, a second review was initiated by the COAG Energy Council in 2016. The consultation paper released as part of the review identified key issues for consideration including:

...the apparent 'cherry picking' of issues for review by network businesses and the focus on correcting individual errors without sufficient consideration of whether a different decision would lead to a materially preferable decision that is in the long term interests of consumers. Other areas for consideration include that the LMR regime is not delivering timely and predictable revenue determinations and continues to present barriers to the participation of stakeholders, such as consumer groups.²³

1.29 The review identified a number of significant regulatory failures including:

...that LMR reviews of economic regulatory decisions remain a routine part of the regulatory process, involve significant costs to all participants, continue to present barriers to meaningful consumer participation, lead to significant regulatory and price uncertainty, and are failing to demonstrate outcomes that serve the long term interests of consumers.²⁴

1.30 At its December 2016 meeting, the COAG Energy Council acknowledged that it was 'a critical time' for Australia's energy market with work being undertaken to 'maintain the security, reliability, affordability and sustainability of the national energy system for all Australians'.²⁵ Ministers agreed that the limited merits review regime was failing to meet its policy intent and had contributed to higher prices for consumers. It was noted that there was no consensus on the Commonwealth's position that the regime should be abolished.²⁶ However, Ministers agreed in-principle to 'significant and immediate reform' of the limited merits review arrangements including:

- tightening and clarifying the grounds for review;
- introducing higher financial thresholds for leave which apply to individual grounds for review;
- reviews to be conducted on the papers, rather than through expensive and adversarial oral hearings;
- introducing strict timeframes for review;
- strengthening the requirement for review appellants to demonstrate that overturning the regulator's decision would not be to the serious detriment of the long-term interests of consumers;

23 COAG Energy Council, *Review of the Limited Merits Review Regime Consultation Paper*, 6 September 2016, p. 4.

24 Explanatory Memorandum, pp. 6–7.

25 COAG Energy Council, *Meeting Communique*, 14 December 2016.

26 COAG Energy Council, *Meeting Communique*, 14 December 2016.

- introducing more flexible arrangements for consumer participation in reviews;
- introducing a binding rate-of-return guideline, with relevant elements of the regulator's decision not subject to merits review;
- limiting the timeframes in which material can be submitted to the regulator so as to remove opportunities for gaming; and
- providing that the costs of reviews, including those incurred by the AER, to be borne by network businesses.²⁷

Federal Court decisions

1.31 In 2015, the AER made decisions related to the maximum revenue that certain network businesses (Ausgrid, Endeavour Energy, Essential Energy, ActewAGL and Jemena Gas Networks (NSW)) could collect from customers to operate networks. Following the AER's decisions, the network companies sought limited merits review, with the Tribunal finding in favour of the AER in some matters and in the favour of the businesses in other areas (operating expenses, cost of corporate income tax and cost of debt).

1.32 Following the decisions, the AER applied to the Federal Court for judicial review. However, in May 2017 the Full Federal Court dismissed most the AER's applications. The Court upheld the AER's appeal in relation to the Tribunal's decision on the cost of corporate income tax but upheld the Tribunal's finding in relation to operating expenses and the cost of debt.²⁸

1.33 The Minister for the Environment and Energy responded to the Full Federal Court's decision by noting that the decision 'will increase electricity prices for New South Wales customers by around \$3 billion'. The Minister reaffirmed the Government's position of wanting to abolish the limited merits review regime 'to stop network businesses from gaming the system'. The Minister added:

The LMR process is the root cause of today's decision which will see consumers paying more through higher electricity prices.

The LMR process allows energy networks to contest decisions of the AER through the Australian Competition Tribunal by appealing how much they can re-coup from customers.

Network businesses only appeal against the decision of the AER if they want to slug consumers more.

27 COAG Energy Council, *Meeting Communique*, 14 December 2017.

28 AER, 'Federal Court judgement on AER electricity and gas price decisions disappointing outcome for NSW and ACT consumers', *Media Release*, 24 May 2017.

It is the clear view of the Turnbull Government that the AER is best placed to make decisions on how much energy companies can re-coup from consumers and not the Australian Competition Tribunal.²⁹

Commonwealth decision to abolish limited merits review

1.34 On 20 June 2017, the Government announced it was 'taking immediate action to put downward pressure on power prices and ensure reliable energy for all Australians'. Additional resources for the AER were announced 'to stop energy network companies gaming the system and overturning rulings in the courts' and foreshadowed the abolition of the limited merits review regime.³⁰

1.35 The bill was introduced in the House of Representatives on 10 August 2017. In his second reading speech, the Minister noted that despite reform of the limited merits review regime, network companies still routinely sought reviews of the AER's decisions, 'essentially using the Australian Competition Tribunal as a second regulator'. The Minister concluded:

Divesting the tribunal of its function of reviewing decisions made under the national energy laws should reduce pressure on electricity prices.

It will put the power back to where it rightly should be, with the regulator. The AER is best placed to prevent inefficient costs being passed on to consumers.

A strong regulator is the best way to reduce pressure on network costs which make up around half of the average electricity bill in Australia.³¹

Key provisions of the bill

1.36 The divesting of the Tribunal of its limited merits review function in respect of reviewable regulatory decisions would be achieved by:

- proposed amendment of subsection 44AI(1): this would make the Commonwealth's consent to the conferral of national energy law functions on the AER subject to the operation of proposed section 44AIA;
- proposed section 44AIA: this would ensure that AER decisions made under the national energy laws are not subject to merits review by any state or territory body;

29 Minister for the Environment and Energy, the Hon Josh Frydenberg, MP, 'States need to put energy consumers first', *Media release*, 24 May 2017.

30 Prime Minister of Australia, the Hon Malcolm Turnbull, MP, Minister for the Environment and Energy, the Hon Josh Frydenberg, MP, Minister for Resources and Northern Australia, Senator the Hon Matt Canavan, 'Securing our energy future', *Media release*, 20 June 2017.

31 Minister for the Environment and Energy, the Hon Josh Frydenberg, MP, House of Representatives, *Hansard*, 10 August 2017, p. 8037.

- proposed amendments of subsection 44ZZM(1): this would make the Commonwealth's consent to the conferral of national energy law functions on the Tribunal subject to the operation of proposed section 44ZZMAA;
- proposed section 44ZZMAA: this would prevent the Tribunal from reviewing decision under the national energy laws, other than decision relating to the disclosure of confidential or protected information collected under those laws.

1.37 Proposed section 44AIA will apply to all AER decisions, whenever made. In effect, no AER decision, whether made before or after the commencement of the amendments, may be reviewed by a state or territory merits review body.³²

1.38 Proposed section 44ZZMAA applies to all decisions made under the national energy laws, whether made before or after the commencement of the amendments, but the existing limited merits review regime will continue to apply to a decision that, at the commencement time, was being reviewed by the Tribunal, provided the application to review the decision was made on or before 20 June 2017 (when the proposed amendments were announced). In effect this means that:

- any reviewable regulatory decision made after the commencement of the amendments cannot be reviewed by the Tribunal;
- decisions made before the commencement of the amendments can only be reviewed if the application for review was made before 21 June 2017;
- any review proceedings that are on foot at the commencement time can continue, but if the Tribunal remits the matter back to the original decision maker, any remade decision cannot be reviewed by the Tribunal; and
- any court order made as the result of any judicial review of a Tribunal determination (whether the order or the determination is made before or after the commencement time) requiring the Tribunal to reconsider its determination can be implemented, but if the Tribunal remits the matter back to the original decision maker, any remade decision cannot be reviewed by the Tribunal.³³

32 Explanatory Memorandum, p. 9.

33 Explanatory Memorandum, p. 9.