# ADMINISTRATIVE LAW IN THE ENERGY SECTOR ACCOUNTABILITY, COMPLEXITY AND CURRENT DEVELOPMENTS

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## Introduction

Competitively sourced and reliable energy is central to the Australian economy and the day-to-day lives of almost every Australian. Energy market reform was recognised as a key part of the Competition Policy Reforms in the 1990s because of the monopolistic nature of the industry and the potential for reform to deliver tangible economic benefits. Energy, particularly electricity, had traditionally been supplied by State and Territory governments through vertically integrated monopolies. The 1990s and early 2000s heralded disaggregation, a competitive spot market for electricity in eastern Australia, access regulation for electricity and gas networks and some privatisation.

The legislative vehicle for many of these reforms was cooperative Commonwealth, State and Territory legislation under the oversight of the Council of Australian Governments (COAG) and each jurisdiction's energy Ministers who came together as the Ministerial Council on Energy (MCE) in 2001. The political landscape for the latest efforts in energy reform is underpinned by the Australian Energy Market Agreement 2004 as amended in 2006 and numerous directives in COAG communiqués. Through consensus approaches, energy market reform is a key example of co-operative federalism in practice.

This paper attempts to sketch out the role of administrative law and in particular rule-making and review mechanisms in ensuring the accountable delivery of the objectives of energy market reform. The focus on the paper is principally on the economic (i.e. price) regulation of the monopoly gas and electricity network infrastructure - the poles, wires and pipes which bring competitive sourced gas or electricity generation to consumers.

There are currently over $50 billion worth of electricity and gas network assets whose service charges are regulated and whose next price reset will be conducted by the Australian Energy Regulator (AER - a Commonwealth body) under a revised national framework for electricity and gas. In electricity, network charges are over 50% of an end user's bill. Accordingly, the administrative law surrounding the rules which define the AER's regulatory task, the ability to amend those rules and the ability to challenge the regulatory decisions of the AER has been hotly debated in the reform program. The regulation of networks is also central to promoting competition in upstream (i.e. electricity generation and gas production) and downstream (e.g. retailing) markets.

This paper will not look specifically at the particular administrative law issues associated with the resources sector (such as those facing upstream gas or coal production), and has a domestic focus rather than looking at those parts of the sector which are export orientated.

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Minerals and upstream issues are coordinated at an intergovernmental level by the Ministerial Council on Mineral and Petroleum Resources (MCMPR). The resources sector has a number of access issues to contend with, each with their own administrative law difficulties, particularly with regard to ports, road and rail infrastructure. Some of these are dealt with in State or Territory regulation,[1] others have become subject to the access regime under Part IIIA of the *Trade Practices Act 1974* (TPA).[2]

There are also numerous issues in the application of the general competition prohibitions in the TPA to the energy and resources sector and the accountability framework for the ACCC in relation to those issues which are not dealt with in this paper. Additionally, new policy initiatives in resources and energy such as carbon capture and storage, water policy and emissions trading have their own administrative law complexities for which it would be premature to comment. Nonetheless, all these areas both need to interrelate with, and can usefully learn from, the strengths and weaknesses of the administrative law framework in network regulation so as to most effectively deliver their policy objectives.

**Objectives of energy reform and the relevance of administrative law**

There will necessarily be differences in the accountability framework for government control over a refugee versus a large monopoly service provider of an essential service. Administrative law is often discussed and argued by lawyers in a legal framework centred around the controls on government action to achieve general objectives of good public governance, accountability, transparency and the protection of individual rights. Much of the administrative law literature and principles have been developed from the testing and analysis of cases where government action infringes on the rights and liberties of individuals.

In the energy sector, while treatment of individual consumer rights (e.g. protections from wrongful disconnection) is a key part of the framework, one of the recent challenges for the MCE has been establishing an accountability framework, through administrative law mechanisms, which deals with the rights of a network service provider to be involved in the development of the rules under which they are regulated and allows them to challenge the decisions of the government regulators who determine how much they can earn. While government accountability in relation to large business interests is by no means a new issue,[3] the market, engineering, commercial, technical and legislative complexities surrounding gas and electricity infrastructure necessitates that administrative law be understood and analysed also by reference to the particular policy objectives in this area.

The most vivid example of the need to adapt administrative law mechanisms to the energy market framework was the debate surrounding whether or not to allow merits review of economic regulatory decisions. Because of the power asymmetries involved, consumer groups were opposed to any review rights beyond judicial review whereas network businesses strongly advocated merits review rights to promote investment in the sector.

The political statement of energy reform objectives comes from the objectives of the AEMA:

> 2.1 The objectives of this agreement are:
>
> (a) the promotion of the long term interests of consumers with regard to the price, quality and reliability of electricity and gas services; and
>
> (b) the establishment of a framework for further reform to:
>
> (i) strengthen the quality, timeliness and national character of governance of the energy markets, to improve the climate of investment;

(ii) streamline and improve the quality of economic regulation across energy markets to lower the cost and complexity of regulation facing investors, enhance regulatory certainty, and lower barriers to competition;

(iii) improve the planning and development of electricity transmission networks, to create a stable framework for efficient investment in new (including distributed) generation and transmission capacity;

(iv) enhance the participation of energy users in the markets including through demand side management and the further introduction of retail competition, to increase the value of energy services to households and businesses;

(v) further increase the penetration of natural gas, to lower energy costs and improve energy services, particularly to regional Australia, and reduce greenhouse emissions; and

(vi) address greenhouse emissions from the energy sector, in light of the concerns about climate change and the need for a stable long-term framework for investment in energy supplies.

The sub-objectives most relevant to the administrative law mechanisms needed for the energy sector are (b)(i) - governance and (b)(ii) - quality of economic regulation along with the general commitment to further the engagement of consumers/end users in (a) and (b)(iv). It is also important for the framework to provide certainty which facilitates efficient investment referred to in (b)(iii).

The AEMA objectives are implemented through a variety of policies and regulation at Commonwealth, State and Territory level. In the cooperative legislative framework for national electricity[4] and gas regulation these objectives are given effect to by the national electricity/gas objective. The national electricity objective provides as follows:

> The objective of this Law is to is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to –
>
> (a) price, quality, safety, reliability and security of supply of electricity; and
>
> (b) the reliability, safety and security of the national electricity system.

The objective was confirmed as the basis for the gas and electricity national frameworks by the Expert Panel on Energy Access Pricing (Expert Panel) which reported to the MCE in April 2006.[5] The objectives are designed to recognise that promoting all aspects of economic efficiency is the best way of delivering benefits for the long term interests of consumers in the gas and electricity energy markets. The regulatory design has been focused upon this single objective to avoid the uncertainty of regulatory and rule-making bodies being asked to balance conflicting objectives in carrying out their functions.

MCE documents have also emphasised that particular social and environmental objectives, which often involve cross-subsidies in economic terms, are best dealt with outside of the national economic regulatory framework through separate initiatives and instruments.[6] Accordingly, the Carbon Pollution Reduction Scheme and expanded renewable energy target are being implemented outside of the cooperative legislative framework. This allows

the energy market framework to focus on an efficiency framework which minimises the costs of these external instruments. [7]

The Australian Competition Tribunal in *Re: Application by ElectraNet Pty Limited (No 3*) [2008] ACompT 3 (30 September 2008) (ElectraNet (No 3)) recognised the centrality of the national electricity objective in carrying out its review function and the particular economic focus of the legislation:

> The national electricity objective provides the overarching economic objective for regulation under the Law: the promotion of efficient investment in the long term interests of consumers. Consumers will benefit in the long run if resources are used efficiently, i.e. resources are allocated to the delivery of goods and services in accordance with consumer preferences at least cost. As reflected in the revenue and pricing principles, this in turn requires prices to reflect the long run cost of supply and to support efficient investment, providing investors with a return which covers the opportunity cost of capital required to deliver the services. [8]

The key tensions in the design of the energy regulatory framework from an administrative law perspective have been:

(a) the extent to which key parts of the framework and government powers are set out in legislation (and hence hard to change in an environment requiring unanimous agreement of all governments) as opposed to those matters that can be dealt with by statutory rules;

(b) the role of the community and the statutory rule–maker in the process of amendment to the statutory rules which bind regulatory bodies and the community alike;

(c) the flexibility/discretion provided to the AER and regulated business under the rules in the context of the level of prescription that is appropriate or possible; and

(d) the nature of the review mechanism for decisions of the AER and whether such a review mechanism will promote outcomes that are in the long term interests of consumers given the asymmetries of interest and information between business, the regulator and consumers.

Consideration of all these issues has resulted in a number of innovative resolutions to attempt to best meet the reform objectives. This paper will look at the role and influence of administrative law in arriving at a position on each of the issues, starting with a general background of the legislative framework and dealing with the four issues in turn. All of these have benefited from extensive engagement with stakeholders through submissions, working groups and consultation sessions run by officials from the Ministerial Council on Energy.

**Co-operative legislative structure**

The electricity and gas regimes hinge upon a complex co-operative scheme which takes it outside of the ordinary relationship between Parliament and the Executive. The complexities of setting up the scheme and making it work within constitutional and practical limitations have key implications for the administrative law mechanisms suitable to ensure decision makers are accountable.

*The current gas and electricity regimes*

The current gas and electricity regimes are co-operative Commonwealth, State and Territory legislative schemes. The Commonwealth and all the States and Territories are part of the gas access regime and all, with the exception of Western Australia and the Northern Territory, participate in the electricity regime. The electricity regime was amended on

1 January 2008 and the gas regime was amended on 1 July 2008 to create consistency between the governance models for electricity and gas and to make other policy changes to both regimes.[9] Under the AEMA, all changes to the collective legislative schemes and their application in each jurisdiction (both laws and regulations) are subject to the unanimous agreement of all energy Ministers.

The schemes work through 'lead' legislation in South Australia:

(a) the *National Electricity (South Australia) Act 1996*; and

(b) the *National Gas (South Australia) Act 2007*.

The Schedule to the lead legislation is then applied as the law in the other States and Territories through 'Application Acts'. The Schedules are referred to as the National Electricity Law (NEL) and National Gas Law (NGL) respectively. Western Australia has not yet applied the revised gas access regime, but expects to do so shortly. [10] The Commonwealth currently applies the regimes to the offshore area through the *Australian Energy Market Act 2004* (the AEM Act).[11]

The current electricity and gas regimes give functions and powers to a statutory rule-maker and market development body, the Australian Energy Market Commission (AEMC), established by the South Australian *Australian Energy Market Commission Establishment Act 2004,* and to the energy regulator the AER, established by Part IIIAA of the TPA. The Commonwealth Parliament consents to the conferral of functions and powers and the imposition of duties on the AER and other Commonwealth bodies through the TPA and AEM Act to overcome any issues raised by the decision in *R v Hughes*. [12]

The National Electricity Rules (NER) are made under the NEL to provide detailed operational regulatory requirements for electricity transmission and distribution and the operation of the wholesale spot market for electricity. The NER have force of law wherever the NEL is applied[13]. They can be amended by the AEMC after a rule-change process defined in the NEL.[14] They currently run to 1151 pages and allow a myriad of other technical, operational and regulatory matters to be dealt with by other guidelines, standards and methodologies promulgated by the AER or the market operator, currently NEMMCO.[15]

There are also a limited number of Regulations made under the *National Electricity (South Australia) Act 1996* and applied in each jurisdiction dealing with machinery matters including aspects of the rule change process and the prescription of civil penalty provisions.

Both the NER and Regulations are not subject to parliamentary disallowance[16] because it is not considered appropriate for the Parliament of one jurisdiction to disallow a legislative instrument that applies to all jurisdictions. The accountability for rule-making is discussed below. The power to make regulations is seen as being constrained by the requirement to unanimous agreement of MCE Ministers and the limited subject matters for which regulations may be made.

All of the instruments are also subject to a comprehensive special interpretation schedule, currently Schedule 2 of the NEL.

The new gas regime implements the governance arrangements agreed in the AEMA consistently with the NEL. The AEMC is responsible for rule–making and market development, while the AER is responsible for economic regulation and enforcement. Additionally, Ministers and the National Competition Council (NCC) retain their existing roles in relation to whether regulation is applied to particular gas networks.

Consistent with the electricity regime, the NGL is supplemented by National Gas Rules (NGR) and a limited number of regulations dealing with minor matters and the prescription of civil penalties. The initial NGR were made by the South Australian Energy Minister on the recommendation of the MCE. The AEMC is now responsible for the ongoing administration of the NGR, under powers given to the AEMC in the NGL. This new framework replaces the current *Gas Pipelines Access (South Australia) Act 1997* and the National Third Party Access Code for Natural Gas Pipeline Systems (Gas Code).[17]

Western Australia will continue to apply the access related parts of the NGL, and differ only in respect to institutional arrangements, namely retention of its local regulator, the Economic Regulation Authority and an independent arbitrator for access disputes.

**Designation of matters in the NEL and NGL**

As mentioned before, a key tension has been to find the right balance between what powers and accountability mechanisms should be provided for by the NEL and NGL themselves and what matters should be delegated to the other subordinate instruments. The scope for Parliamentary and/or Ministerial oversight of the different subordinate instruments has been a key concern for governments and stakeholders in this process. Put simply, the laws are essentially a reflection of the policy choices of the politically accountable executive governments through the MCE process whereas the rules are subject to the policy choices of the AEMC subject to the guidance and constraints provided by the laws. The challenge is finding the appropriate means of providing discipline on the decision makers in the regime to provide an appropriately transparent level of accountability. Broadly, the architecture for the regimes after the amendments is as follows:

***Matters governed exclusively in the law***

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|---|---|
| **The objective of the law and high level economic principles** | The objective and other high level economic principles (form of regulation factors and revenue and pricing principles) are set out in the law and the law requires the AER and AEMC to take them into account in particular circumstances. |
| **Rule-making** | The scope of the power to make rules (s 34 of the NEL) and the power for the AEMC to amend the rules in accordance with detailed consultation requirements is in the law (Part 7). |
| **Enforcement powers of the AER** | These include<br>— investigation powers (including search warrants);<br>— general information gathering power (s 28 of the NEL); and<br>— powers to commence proceedings and issue infringement notices. |
| **Advisory/review powers for the AEMC** | The ability for MCE directed reviews and reviews by the AEMC on their own initiative. |

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|---|---|
| **Review of decision-making of AEMC, AER and other regulatory decisions** | Judicial review is provided for AEMC decisions and AER decisions (through *Administrative Decisions (Judicial Review) Act 1977* (ADJR Act). A limited merits review model is provided for AER economic regulatory decisions and a few other regulatory decisions. |
| **Treatment of confidential information by regulatory bodies** | Dealing with protection and disclosure of confidential information. |
| ***Matters for Regulations*** | |
| **Machinery and whole of government matters** | These include<br>— prescribing civil penalty provisions;<br>— minor details of the rule change process (e.g. information requirements)<br>— Savings and transitional issues; and<br>— Liability/immunity issues concerning the market operator/AEMC. |
| ***Matters for law and rules*** | |
| **Requirements for registration to participate in the national electricity market (NEM)** | There are detailed registration requirements in chapter 2 of the NER, however the obligation to be registered rests in the NEL. |
| **The scope of regulation** | Coverage in gas and the definition of the networks in electricity is in the laws, with more minor or technical issues in the rules. Limited 'greenfield' exemptions from regulation are in the NGL. |
| **Form of regulation** | A differentiation between upfront price control and a negotiate/arbitrate framework is set out in the laws with further details in the rules. |
| **AER regulatory information powers** | The power to require information to be maintained, kept and produced to the AER in particular forms is in the laws. There is a limited role of rules to clarify one of the tests regarding who may be issued with a notice.[18] |
| **Provision for access disputes between a network and user** | The high level framework for the AER to resolve disputes about access to a network is in the laws, with additional detail in the rules. |

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| **Performance Reporting** | The power for the AER to prepare performance reports on the operation and financial performance of network service providers is in the law but is subject to limited consultation requirements in the rules. |
| **A number of high level competition and operation separation requirements** | High level competition law prohibitions (such as a prohibition on preventing and hindering access) and separation requirements (ring-fencing) are in the laws, with further details in the rules. |
| **Safety and security issues in the NEM** | High level powers of NEMMCO to ensure system security and operation are in the laws with further detail in the rules. |

***Matters contained in the rules***

| | |
|---|---|
| **Electricity market operation and trading** | Extensive rules on the wholesale market, market system security and metering of electricity. A process for resolving market disputes is in Chapter 8 of the NER. |
| **Network planning and access requirements** | Extensive rules in electricity, more limited rules in gas concerning facilitation of request for access. |
| **The content, consultation requirements and guidance for economic regulation of networks** | Subject to a requirement in the laws to take into account the revenue and pricing principles, the rules govern all other aspects of the AER's functions and powers in this area. |

The objective of the framework is that traditional executive governmental powers are enshrined in legislation whereas market and complex regulatory issues are left to the subordinate rules. Governments have ensured that review mechanisms for decisions that affect a party's interests are in the law, while the actual rules that govern the AER's decision-making are within the power of the AEMC to amend and develop over time through the rules.

**Institutional 'separation of powers'**

Another key achievement of this delegated rule-making function is to enshrine separation between rule-making, and hence policy development, and the task of applying and enforcing the rules. This 'separation of powers' is another institutional innovation of the energy reforms to deal with the perception of regulatory creep by government agencies without the need to refer more matters back to the scrutiny of Parliament. However, this does not prevent the AER from having other functions to promulgate additional detailed requirements, methodologies or guidelines delegated to it by the rules.

The key feature and accountability mechanism of these additional requirements is that they always remain subject to the guidance, limitations and constraints imposed by the rules and are subject to amendment through the rule change process. A flexible and market driven process for amending the rules means scrutiny of the outcomes of every AER decision can

be assessed to determine if there are any rules which should be amended before their next application to the same or another business. The threat of a rule change needs to be seen as an ultimate administrative law accountability mechanism imposed upon the AER in relation to the exercise of its powers.

**Delegated rule-making**

The process for amending a rule is a key administrative law innovation in the energy sector to provide an appropriate accountability framework for the AEMC's significant role in the market. To accommodate the development of the rules to further the policy objectives of MCE, the architecture of the rule change process in the laws is as follows:

(a) the process for amending a rule may be initiated by any person, although the AEMC may not initiate a rule change other than for corrections of errors or non-material changes;

(b) rule change applications must be accompanied by a justification for the changes proposed;

(c) final determination by the AEMC with optional public hearings or other consultative mechanisms; and

(d) the AEMC may only make a Rule if it is satisfied that the Rule will or is likely to contribute to the achievement of the national electricity/gas objective - the rule-making test.

(e) The AEMC must also have regard to:

- the revenue and pricing principles and form of regulation factors in the law when making particular types of rules; and
- any MCE Statement of Policy Principles issued under the law (such as the May 2008 MCE Statement of Policy Principles in regard to smart meters); and

(f) AEMC decisions must be fully justified with detailed reasons.

The above architecture is intended to make the AEMC responsive to requests for changes from all those affected by the rules and make the AEMC the impartial decision maker between competing views. While the AEMC cannot initiate rule changes, the recent amendments clarify that the AEMC can respond to a rule change request by making the rule which better achieves the statutory objective rather than just make incremental improvements suggested by the original proponent (referred to as a more preferable rule).

By utilising an open and transparent rule change process, the model is designed to better accommodate the ultimate goal of furthering the long-term interests of consumers and service providers. Because rule-making, even within the bounds of its enabling legislation, is essentially a policy matter, judicial rather than any merits review is provided for decisions of the AEMC. This accords with the Administrative Review Council Guidelines 'What Decisions Should be Subject to Merits Review?' which indicates that legislation-like decisions should not be subject to merits review.[19]

The AEMC has dealt with over 50 rule changes since July 2005 and currently has 21 rule change applications on foot. Despite the fact that there is ‘open standing’ for anyone to request changes to the rules, there has not been a flood of frivolous or vexatious applications to the AEMC. The fact that submissions from almost all stakeholder groups

have been critical of particular aspects of decisions taken by the AEMC is more an indication of the lively debate and magnitude of the decisions taken in the rules for the economic interests of each stakeholder rather than a failing in the administrative law accountability model applicable to the AEMC.

Despite being strictly guided by the objective, the AEMC has considerable discretion in making policy choices for the future development of the rules. This discretion is underlined by the fact that the AEMC in making a rule can weigh up different aspects of the national electricity/gas objective as it considers appropriate in the circumstances.[20] Accordingly, the AEMC is primarily accountable through its appointment and reporting to the MCE, legal requirements for making rules that contribute to the achievement of the objective, public consultation and scrutiny requirements and the ability for guidance through an MCE Statement of Policy Principles.

**A 'fit–for–purpose' decision making model for setting revenue/price of networks**

The decision-making model, and in particular the roles of the AER and regulated business, has been one of the most vexed issues of energy market reform. The key interests from an administrative law perspective are the role of prescription in enhancing accountability and the role that the nature of the individual decision rules play in determining whether merits review is necessary to complement the inherent existence and recourse to judicial review remedies.

The decision-making model was one of the core questions debated and commented upon by the Expert Panel. The debate has been compartmentalised into possible AER decision-making models:

(a) 'consider–decide' (also called submit-determine or receive-determine) where the fundamental premises is that the ultimate discretion for an aspect or the whole of a regulatory decision rests with the AER within the guidance and limitations offered by the law. In this model, the AER may prefer what it considers the best solution, value or mechanism rather than be limited by first needing a ground to reject the proposal of the service provider;

(b) 'propose–respond' where the AER's task is to assess a proposed aspect or the whole of a regulatory decision and is forced to accept the proposal where it is within the bounds defined by the rules.[21] In this model the AER cannot prefer what it considers a better outcome if the service providers proposal is compliant with the test in the rules; and

(c) 'fit-for-purpose' where the rules use a combination of consider-decide and propose-respond decision making models in a way that best achieves the objectives and revenue and pricing principles. This is essentially a hybrid approach and leaves the scope of the AER's discretion in the hands of the AEMC.

The Expert Panel warned that an unconstrained propose-respond model was likely to result in a 'systemic increase in the returns of regulated entities relative to the receive-determine/consider-decide model'[22] but equally warned against enshrining a consider-decide model. It is unsurprising that consumer/user groups prefer consider-decide and regulated entities have lobbied for a propose-respond framework. The MCE policy position is to adopt the Expert Panel recommended 'fit-for-purpose' framework in the laws such that the AEMC determines how the AER exercises its economic regulatory functions through its open consultation process.

The AEMC has already applied its understanding of 'fit-for-purpose' in its decisions on the regulation of electricity transmission services[23] and the MCE applied its understanding of the

fit-for-purpose framework for the initial rules for the regulation of distribution networks by the AER and in the initial NGR in light of the AEMC's work to date. The NGR implement the decision through a meta-decision rule:

> **40 AER's discretion in decision making process regarding access arrangement proposal**
>
> **No discretion**
>
> (1) If the Law states that the AER has no discretion under a particular provision of the Law, then the discretion is entirely excluded in regard to an element of an access arrangement proposal governed by the relevant provision.
>
> **Limited discretion**
>
> (2) If the Law states that the AER's discretion under a particular provision of the Law is limited, then the AER may not withhold its approval to an element of an access arrangement proposal that is governed by the relevant provision if the AER is satisfied that it:
>
> (a) complies with applicable requirements of the Law; and
>
> (b) is consistent with applicable criteria (if any) prescribed by the Law.
>
> **Full discretion**
>
> (3) In all other cases, the AER has a discretion to withhold its approval to an element of an access arrangement proposal if, in the AER's opinion, a preferable alternative exists that:
>
> (a) complies with applicable requirements of the Law; and
>
> (b) is consistent with applicable criteria (if any) prescribed by the Law.

Nonetheless, the debate over 'fit-for-purpose' is to some extent a time-consuming distraction from the real task of defining the AER's role with respect to each aspect of a revenue/price proposal from a regulated entity. Generally, the greater the level of prescription, the more confident the regulated businesses feel with the AER having discretion in a particular area with regard to the application of those rules. The result of the 'fit-for-purpose' framework in electricity transmission is that the rules enshrine some of the most detailed aspects of complex regulatory methodology with the force of law. They are probably the most detailed rules for economic regulatory methodology in the world which are not made by the body which also carries out the regulation task itself.

**How the AER makes economic regulatory decisions**

The current 'building blocks methodology' for electricity transmission involves a process of at least 13 months to develop a five year price path based on revenue and/or price constraints. To settle on an 'allowable revenue' over the five year period the following need to be determined:

(a) the exact assets/services which fall within the scope of revenue regulation and those which fall within a negotiate/arbitrate or unregulated framework;

(b) operating and capital expenditure forecasts for the next 5 years (potentially billions of dollars each for some network businesses);

(c) the capital asset value of the business, amended to take into account past and future efficient investments;

(d) an appropriate rate of return on the capital asset value commensurate with the regulatory and commercial risks involved;

(e) the treatment of depreciation of the assets within the regulatory asset base;

(f) a treatment of taxation for the five year period;

(g) what events will impact or change the revenue allocation over the five year period;

(h) applicable service, efficiency and demand management incentive mechanisms to counter incentives created by the building blocks approach that would be inconsistent with the objective; and

(i) how the allowable revenue will be turned into prices (i.e. price cap or revenue cap).

There are also annual limitations on how particular prices are charged (i.e. pricing rules) which further guide how a regulated business recovers its allowable revenue. These essentially answer the question of 'who pays' for a particular service/revenue allowance.

The AEMC's fit-for-purpose model essentially:

(a) decides some of these matters in the rules themselves (e.g. fully regulated services are prescribed and a formula and values for the return on capital (WACC) are listed in the rules);

(b) gives the AER the discretion to determine aspects of the decision in a way it thinks best (generally consider-decide), usually through empowering the AER to issue models, schemes or methodologies (e.g. efficiency benefit sharing and service performance incentives);
(c) gives weight to aspects of a service providers proposal, such that amounts, values or estimates of a service providers proposal must be accepted if they meet the detailed requirements of the rules (e.g. capital and operating expenditure).

The necessary complexity of the regulatory process for such large and significant services makes end user involvement in the regulatory process difficult. Draft and final decisions frequently run into hundreds of pages. The Expert Panel recognised an information asymmetry between business and regulator and even greater asymmetry between the business and users due to the confidential nature of much of the information. The uncertainty inherent in the regulatory model which attempts to predict and regulate five years into the future is also another key pressure of decision-making and accountability arrangements. The key concern for the rule-maker and the regulator is to strike the appropriate balance between allowing a service provider to earn an appropriate return with incentives to make further efficiency gains without compromising reliable service delivery while ensuring consumers pay no more than is necessary for this outcome.

The rest of this paper will look at how administrative law review mechanisms operate on this complex legal environment to contribute to the achievement of the reform objectives.

**Complexities of judicial review in the energy sector**

Judicial review of all governmental decisions in the energy sector is a given accountability measure upon which all stakeholders agree. The actions of the AEMC, AER and other regulatory bodies (e.g. the NEM dispute resolution panel, National Competition Council, NEMMCO and energy Ministers) are all subject to judicial review. State and Territory bodies are subject to judicial review in State or Territory Supreme Courts[24] and Commonwealth bodies are subject to judicial review through the inclusion of the electricity and gas regimes in Schedule 3 of the ADJR Act. The test for standing in the both cases is the 'person aggrieved' test.

The administrative law debate in the energy sector over the last four years has centred on the question of whether or not judicial review is a sufficient review mechanism or whether some form of merit review is required. [25] As acknowledged in the October 2005 MCE consultation paper, the nature of the regulator's task and the level of prescription in the rules will be a key determinate of the effectiveness of judicial review as being an appropriate and useful accountability discipline on the decision maker. It is undeniable that the additional criteria and prescription in the rules for the AER in exercising its discretion as the result of the application of the 'fit-for-purpose' model provide a far greater number of rules whose application could be subject to judicial review challenge.

Nonetheless, the significance of the economic regulatory decisions of the AER and their legal and economic complexity will continue to pose significant challenges to administrative lawyers and the courts in judicial review applications. In assessing the application of the rules, Courts may be asked to assess the application of complex and specific formula such as:

$$\mathrm{WACC} = \mathrm{k_e}\,\frac{E}{V} + \mathrm{k_d}\,\frac{D}{V}$$

or

$$\mathrm{ETC_t} = (\mathrm{ETI_t} \times \mathrm{r_t})\,(1 - \gamma)$$

or be asked to look at the assessment by the AER of large amounts of future expenditure against economic principles of efficiency, prudence and realistic assumptions of demand growth. [26] The decision of *Re Michael; Ex parte Epic Energy (WA) Nominees Pty Ltd* [27] demonstrates the traps for a regulator to fall into errors of law in interpreting and giving effect to layers of objectives and principles in the previous gas access regime.

Nonetheless, despite their prescription the 'fit-for-purpose' rules do still give the AER significant discretion to exercise in assessing complex factual matters and allow the weighing up of criteria to come up with on-balance outcomes. Even with very detailed rules, the economic regulatory framework remains complex and subject to judgement calls by the regulator on key parts of the building block methodology. It is particularly with regard to these factual and judgement matters that service providers have emphasised that a judicial review model would be unable to provide the necessary level of oversight and accountability to adequately protect their legitimate businesses interests and create a climate for continued investment in the sector.

Additionally, in the more detailed regulatory framework, the issue of when and how expert evidence can be used will always be complex. This is demonstrated by the relevant case law:

(a) In *Re Michael; Ex parte Epic Energy (WA) Nominees Pty Ltd*[28] the Full Court of Western Australian Supreme Court noted the usefulness of expert economic evidence in assisting the court to understand the economic concepts used in, and underlying, the current gas access legislation yet had significant problems with the particular evidence lead which went beyond the interpretation task or applied economic theory without close connection with the precise form of the legislation being examined.[29]

(b) In *BHP Billiton Iron Ore Pty Ltd v National Competition Council (No 2)*[30] the NCC was ordered to pay some of the costs of the applicants because the Court did not see any use of its expert economic evidence on the concept of what was a 'production process' under Part IIIA of the TPA. The original decision stated that:

> No party asserted that the term 'production process' has a technical or specialised meaning in economics. On that basis, it is not possible for the Court to construe those words other than in accordance with their most ordinary and natural meaning. It is therefore not permissible to receive the views of witnesses, expert or lay, as to their preferred interpretation or to explain how the words of a statute would be expected to be applied to the circumstances of the case: *Royal Insurance Australia Ltd v Government Insurance Office (NSW)* [1994] 1 VR 123 at 133-4. Such evidence is nothing more than submission and argument and indeed an attempt to usurp the judicial function.[31]

(c) In *TXU Electricity Ltd v Office of the Regulator General & Ors* [32] the issue of the 'CPI-X' building blocks methodology needed to be explained by reference to expert economic evidence for the legislative scheme to make any sense.

To the extent judicial review of decision-making in the energy sector becomes more prevalent, the Courts will continue to come to terms with how to unpick the problem and apply administrative law principles effectively and efficiency to the issues raised.

**The 'limited merits' review model**

In June 2006 MCE made a policy decision that judicial review was not a sufficient review mechanism for the economic regulatory decisions of the AER and that a limited merits review model would best achieve its reform objectives. In coming to this decision, the MCE decision noted its decision was based on the following criteria for developing an appropriate review scheme which were in turn based upon its own reform objectives:

(a) maximising accountability;

(b) maximising regulatory certainty;

(c) maximising the conditions for the decision-maker to make a correct initial decision;

(d) achieving the best decisions possible;

(e) ensuring that all stakeholders' interests are taken into account, including those of service and network providers, and consumers;

(f) minimising the risk of 'gaming'; and

(g) minimising time delays and cost.[33]

The limited merits review model is largely based upon the merits review model operating in the previous gas access regime[34] but has been adapted to better achieve the reform objectives and criteria for assessing the merits review model. The drafting of the provisions establishing the merits review model was subject to consultation in the exposure drafts of the

NEL and NGL. The architecture of the review model and the concerns of stakeholders which the model attempts to address are set out below.

**Key stakeholder concerns with merits review**

During consultation stakeholders raised a number of criticisms of merits review models for the energy sector with consumer and user groups being most vocal that a merits review model would not promote their long-term interests. These concerns were essentially based on the complexity and asymmetries in the regulatory review process outlined above. In particular:

(a) regulated service providers are able to 'cherry pick' key aspects of a decision because of their asymmetric information advantage over other parties. The result is all upside for the regulated business;

(b) regulated service providers have a direct interest in improving every aspect of a regulatory decision whereas the costs to end users of these changes will be minimal in overall terms (i.e. a minor change in the rate of return would have a huge financial impact to the service provider but would be smeared over the customer base);

(c) the ordinary standing arrangements prohibit broad involvement of end users in the process whereas the regulator's decision has been the result of extensive consultation and consideration for over a year;

(d) a regulated service provider will essentially pass on the costs of litigation through its regulated fees and charges with the implication that customers pay twice in opposing a merits review challenge;

(e) regulated service providers may forum shop between judicial and merits review to take advantage of the relative complexities;

(f) a tribunal, which necessarily has less staff and access to expertise than the regulator, may misapply the complexities or facts of particular cases to the detriment of consumers; and

(g) the concern that the fear of complex and expensive merits review challenges will make the regulator err in favour of regulated service providers who are most likely to appeal.

**Addressing concerns - standing and costs**

Standing to commence proceedings and intervene in proceedings once commenced is an important area where the review model attempts to bring consumer groups into the limited merits review framework. Standing to commence or intervene in proceedings has been a significant concern for user/consumer groups in the current gas access regime and other State review regimes. In *Application by Orica IC Assets; re Moomba to Sydney Gas Pipeline (No 2)*[35] the Australian Competition Tribunal refused standing to the Energy Users Association of Australia (EUAA) and Energy Action Group (EAG) noting that merely having objects and purposes directly related to the decision in question was not a ground to granting standing.[36] Under the new regime the following persons will have standing to commence proceedings:

(a) the service provider themselves;

(b) users or end users whose commercial interests are materially affected by the decision; and

(c) a user or consumer association (a body with members who are users or end users and which promotes their interests in relation to the provision of regulated services).

These persons will also have to demonstrate that there is a serious issue to be tried, the error alleged is material to the operation or effect of the decision[37] and that they had been involved in the original decision making process. Leave may also be refused to a service provider who has withheld information, mislead the decision maker, delayed the decision or failed to comply with directions of the decision maker. The aim is to have a fair but relatively narrow gate for the commencement of proceedings. However, broader intervention powers are available for:

(a) anyone with a 'sufficient interest' in the decision being reviewed (including the service provider themselves);

(b) a Minister of a participating jurisdiction; and

(c) user or consumer associations and interest groups (where interest groups do not need to have members but have objects or purposes to represent and promote the interests of users or end users).

The wide intervention powers are designed to ensure all relevant matters are brought to the Tribunal's consideration in a review and the service provider's choice of initiating a merits review will not always be a win-win situation. To further facilitate the intervention by user or consumer associations representing small to medium consumers, those organisations along with the original decision-maker will not be subject to any costs orders unless they conduct their case regardless of the costs, time and arguments of the applicant.

The role of Ministers in intervening in the merits review process is also a feature of the public policy implications of the regulatory decisions and is analogous to the standing attributable to members of the EU in competition law matters through Article 230 of the European Convention.

Costs will remain another deterrent for other parties to a review although a proposal for there to be a presumption of indemnity costs was dropped by the MCE.

**Addressing concerns - role of the decision-maker and grounds of review**

As another counter-balance to the position of the regulated entity and the Tribunal, the original decision-maker, in most cases the AER, has been made a full party to proceedings to counter the limitations which the *Hardiman* principle may impose[38]. The depth of expertise of the regulator in explaining and justifying its position was seen as essential to a better outcome being achieved by the Tribunal. Additional aspects to enhance the role of the original decision-maker include:

(d) the Tribunal is required to have specific regard to any public policy document relied upon by the original decision-maker in making its decisions;

(e) the original decision-maker may also raise other matters related to a ground of review or outcomes or effects consequential to the issues already raised;

(f) the review application will not stay the operation of any price or revenue determination coming into effect; and

(g) the Tribunal will be able to refer complex matters back to the original decision- maker to correct an error rather than do its own calculations.

The grounds for the Tribunal to overturn a decision are also limited, further emphasising the appropriate deference to the views of the regulator in coming to its view on matters where reasonable minds may differ. Any applicant for merits review will need to establish that:

(a) the original decision-maker made an error of fact in its findings of facts, and that error of fact was material to the making of the decision;

(b) the original decision-maker made more than 1 error of fact in its findings of facts, and that those errors of fact, in combination, were material to the making of the decision;

(c) the exercise of the original decision-maker's discretion was incorrect, having regard to all the circumstances;

(d) the original decision-maker's decision was unreasonable, having regard to all the circumstances.

These grounds were expected to retain the meaning set out by the Full Federal Court in interpreting essentially the same grounds in the Gas Pipelines Access Law in *ACCC v Australian Competition Tribunal.*[39] This was broadly confirmed by the Tribunal in ElectraNet (No 3) at [64] – [79]. Accordingly the finding of fact grounds (a) and (b) will include:

(a) the existence of an historical fact being an event or circumstance;

(b) the existence of a present fact being an event or circumstance; and

(c) an opinion about the existence of a future fact or circumstance.

The Full Federal Court made clear that the third aspect of facts 'should encompass opinions formed by the ACCC based upon approaches to the assessment of facts or methodologies which it has chosen to apply' (at [171]). The Full Federal Court at [176] explained that the Tribunal when considering whether the 'incorrect' or 'unreasonable' grounds (which will be (c) and (d) above) are made out, has to do more than simply prefer a different outcome to overturn the regulator's discretion. However, the Full Federal Court rejected the argument that the unreasonable ground was limited to *Wednesbury* unreasonableness[40]. The Full Court explained that:

> The concept of 'unreasonableness' imports want of reason. That is to say the particular discretion exercised by the ACCC is not justified by reference to its stated reasons. There may be a error of logic or some discontinuity or non sequitur in the reasoning. It may be that the discretion has an element of arbitrariness about it because there is an absence of reason to explain the discretionary choices made by the ACCC in arriving at its conclusions.[41]

The Tribunal in ElectraNet (No 3) also added that:

> In addition, of course, the exercise of a discretion may miscarry because it is based upon a misconstruction or misapplication of the relevant principles or methodologies or factors required to be considered by the Law or by the Rules, or by a failure to have regard to a mandatory relevant factor as prescribed by the Law or by the Rules, or where its exercise is affected by the regulator taking into account a factor extraneous to those relevant by reason of the Law and the Rules.[42]

The Tribunal also saw the unreasonableness ground as an overarching ground of review such that '[t]he unreasonableness must be of the AER's decision itself, not of a step in its factual findings or its reasoning. It is important to recognise that it is the AER's decision which must be unreasonable having regard to all the circumstances before that ground is enlivened.'[43]

Overall, the grounds of review and the other mechanisms for the decision-maker to be involved in the review should ensure that appropriate deference is given to the expertise and findings of the regulator in light of the consultative process. This should still providing significant scope for the Tribunal to correct regulatory errors which would not be dealt with through judicial review.

**Addressing concerns - admissible evidence**

Another core limitation for the merits review model is that evidence and submissions will be limited to matters raised before the original decision maker in making out a ground of review. However, once a ground of review is made out the review body may allow new information or material if the material would assist it in making a determination and was not unreasonably withheld from the decision-maker. The limitation on evidence is aimed at addressing risks of information gaming by regulated service providers. The basic limitation on new evidence is replicated from the GPAL and has been narrowly interpreted to preclude attempts to bring in additional evidence into the review framework.

In *Envestra ltd v District Court of South Australia and Anor* [44] the South Australian Supreme Court determined that the provisions did not allow the calling of an expert witness whose report had previously been considered by the South Australian regulator. The restrictions on evidence were recognised and incorporated by COAG into the Competition Principles Agreement on 13 April 2007.[45]

**Which decisions - the challenge of pre-decisions**

The MCE clearly committed to limited merits review of the administrative revenue/price setting decisions of the AER (i.e. the application of the law/rules to an individual business) while at the same time deciding that the policy orientated rule-making decisions of the AEMC were not suitable for review. The issue that was debated extensively in the finalisation of the NEL and NGL was in respect to where the rules set out pre-decisions on aspects of a regulatory proposal (e.g. agreeing on a form of price control before the submission of a detailed proposal) or where an industry-wide policy decision has been delegated to the AER through the rules (such as a review of the parameters for applying a market wide rate of return for all businesses in electricity transmission). Network businesses argued that all AER decisions should be reviewable because of their significant financial impact across the market. The MCE decided not to make such pre-decisions or industry wide decisions reviewable because reviews of pre-decisions would compromise the regulatory process and industry wide decisions were considered essentially legislative in character in the sense of setting out general rules rather than the application of the rules to particular facts.

**Broader context of accountability**

The decision to introduce a limit merits review should also been seen in the context of other administrative law accountability mechanisms in place to achieve the reform objectives. The October 2005 consultation paper noted that apart from the review model and more prescriptive rules:

> Transparent, fair and reasonable decision-making that also produces economically efficient outcomes is [also] a product of:
>
> i. Strong institutional structure of the decision-makers: eg. AER member appointments and external policy accountabilities, internal management, public reporting requirements and financial accountabilities;
>
> ii. Role clarity for decision-makers within the energy sector via the statutory conferral of functions and powers;

iii. Clear and effective procedural and consultative requirements in the NEL and the NE Rules and in the Gas Pipelines Access Regime as to how the decision-makers will perform their economic functions. [46]

## Conclusion

Under the new national framework the AEMC has been delegated significant power by Parliament to shape the future regulation of electricity and gas network charges representing a significant part of each end users' bill. The AER in applying the rules also has an incredibly complex task for which there will always be power and information asymmetries to contend. The choice of administrative review mechanisms - judicial review for rule-making and limited merits review for economic regulatory decisions of the AER has been driven by the complexities inherent in a framework for regulating such important essential services which can only be provided through monopoly infrastructure (with the possible exception of some gas transmission networks). The cooperative scheme has also limited the role of Parliaments in the development and ongoing involvement in the detail of the scheme.

In agreeing to the limited merits review model, the MCE also agreed to thoroughly review its operation before 2015.[47] Accordingly, the role and outcomes generated by administrative law accountability mechanisms will be a continuing source of debate and analysis in the energy sector. With so much at stake and a climate of inherent uncertainty, the framework must remain open to change and further assessment in light of the objectives it was established to achieve.

**Endnotes**

1 Note in particular the port facilities at Dalrymple Bay regulated by the Queensland Competition Authority - see www.qca.org.au
2 Note in particular the Mt Newman and Goldsworthy railways lines declaration decision and related proceedings - see www.ncc.gov.au.
3 Note that the Administrative Review Council recently done some work on most effective and efficient administrative accountability mechanisms for decisions in areas of complex and specific business regulation.
4 Note that WA and the NT do not currently participate in the legislative arrangement for electricity. These jurisdictions are not inter-connected with the national grid in the other States and Territories and have separate regulatory arrangements which are cognisant of the reform objectives.
5 For the full report see www.mce.gov.au. The report also has a very good summary of the Energy Reform process and legislative structure.
6 See in particular the Standing Committee of Officials (SCO) response to the submissions of the National Gas Law and National Electricity Law.
7 With this in mind, the AEMC is currently reviewing the energy market framework in light of the Carbon Pollution Reduction Scheme and expanded renewable energy target to determine what changes might be necessary.
8 At [16] The Tribunal also gave particular emphasis to the objective in paragraph 201 where it stated '[e]fficient investment in the long term interests of consumers will not be promoted if investors perceive a significant risk that the rules will change and they will not be able to recover the opportunity cost of capital reasonably invested. The minimisation of regulatory risk, consistent with the promotion of efficient investment, is one of the tenets that has driven the development of regulatory regimes in Australia. That tenet is reflected in the objective of the Law and in the revenue and pricing principles embodied in the Law.'
9 *National Electricity (South Australia) (National Electricity Law – Miscellaneous Amendments) Amendment Act 2007*.
10 The National Gas Access (Western Australia) Bill 2008 was introduced into the Western Australian Parliament before the election but lapsed when the Parliament was prorogued.
11 See the *Australian Energy Market Amendment (Gas Legislation) Act 2007*(Cwlth).
12 (2000) 202 CLR 535. See ss 29BA and 44AI of the TPA.
13 See s 9 of the NEL which gives the rules the force of law.
14 See Part 7 of the NEL and the discussion at para 0 following.
15 See version 22 of the NER on the AEMC website. NEMMCO is a Corporations Act company which operates the wholesale trading market and performs system security functions. It is intended to be replaced by an Australian Energy Market Operator (AEMO) - see COAG Communique, 13 April 2007.
16 See ss 11(5) and 13 of the *National Electricity (South Australia) Act 1996.*

17 Note that the Schedules of the *Gas Pipelines Access (South Australia) Act 1997* which include the Gas Code are collectively known as the Gas Pipelines Access Law (GPAL).
18 See s 28B(2)(f) of the NEL.
19 See also p 22 and 23 and Annexure C of the Review of decision-making consultation paper released in October 2005 – www.mce.gov.au .
20 See s 88(2) of the NEL.
21 The 'propose-respond' model has been seen to have been the result of the decision in *Application by GasNet Australia (Operations) Pty Ltd* [2003] ACompT 6 (23 December 2003) which stated at [29] 'Different minds, acting reasonably, can be expected to make different choices within a range of possible choices which nonetheless remain consistent with the Reference Tariff Principles. … it is beyond the power of the Relevant Regulator not to approve the proposed AA simply because it prefers a different AA which it believes would better achieve the Relevant Regulator's understanding of the statutory objectives of the Law.' The upward bias is seen to come from the service provider always choosing the most favourable choice with the acceptable range of responses.
22 Expert Panel p 78.
23 See archived AEMC rule changes on 'Economic Regulation of Transmission Services' and 'Pricing of Prescribed Transmission Services' at www.aemc.gov.au. A number of legal advices concerning the models appear on the AEMC website including advices from Stephen Gaegler SC, Neil Williams SC and an AGS opinion from Robert Orr QC and the author to the Department of Industry, Tourism and Resources.
24 See s 70 of the NEL. However, in relation to the Commonwealth application of the regimes in the offshore area, review is in the Federal Court.
25 For some of the early academic debate see Justin Gleeson SC and John Tamblyn's papers entitled 'Administrative Law Meets the Regulatory Agencies: Tournament of the Incompatible?' presented to the 2004 Public Law Weekend Administrative Law Conference.
26 See rules 6A.6.6(c) and 6A.6.7(c) for the latter point, and rules 6A.6.2 and 6A.6.4 for the use of the formulas.
27 (2002) 25 WAR 511.
28 supra.
29 See in particular paragraphs [107] - [110].
30 [2007] FCA 557 (19 April 2007).
31 *BHP Billiton Iron Pty Ltd v National Competition Council* [2006] FCA 1764 at [168].
32 [2001] VSC 153 (17 May 2001).
33 See the MCE Decision on Review of decision-making in the gas and electricity regulatory frameworks on the MCE website - www.mce.gov.au at p 3. The decision has a very extensive discussion on the considerations for in the MCE and the reasons for choosing the particular merits review model in light of previous decisions.
34 See ss 38 and 39 of the GPAL.
35 (2004) ATPR 41-991.
36 At [12]. Consumer groups have also been refused standing under the Essential Services Commission Act 2001(Vic) because of the nature of the review mechanism.
37 See *Re: Application by ElectraNet Pty Ltd* [2008] ACompT 1 (23 June 2008) at [39] – [42] and [60] – [63]. For revenue errors the materiality must be at least $5m or 2% of the annual regulated revenue of a network service provider.
38 *R v Australian Broadcasting Tribunal; Ex parte Hardiman* (1980) 144 CLR 13.
39 [2006] FCAFC 83 at [169] to [180].
40 At [177].
41 at [178]. This was also quoted in *Electranet (No 3)* at [65].
42 At [66].
43 At [74].
44 [2007] SASC 177 (18 May 2007)
45 The Competition Principles Agreement now reads as follows:
6(5)(c) Where merits review of decisions is provided, the review will be limited to the information submitted to the original decision-maker except that the review body:
(i) may request new information where it considers that it would be assisted by the introduction of such information;
(ii) may allow new information where it considers that it could not have reasonably been made available to the original decision-maker; and
(iii) should have regard to the policies and guidelines of the original decision-maker (if any) that are relevant to the decision under review.
46 See p 2.
47 See s 71Z of the NEL.