

**Submission to the Ministerial Council on Energy
Standing Committee of Officials on:**

**Appeal Rights in Energy Regulation in the New
National Regulation Model**

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1. Introduction

This submission is from a large number of regulated businesses in Australia that reflects the industries concern with the issues of appeal rights in the new national regulatory model.

The companies have strong concerns regarding the possible limitations on existing avenues of merits (administrative) appeals that appear to be indicated by the Ministerial Council on Energy (MCE) Information Paper on Inter-governmental Agreement and Legislative Framework (referred to in this submission as the Information Paper). The Information Paper states that there will be provision for only 'judicial review' of Australian Energy Regulator (AER) and Australian Energy Market Commission (AEMC) decisions.

Full and fair appeal rights are an essential component of an effective and efficient regulatory model. Best practice regulation means that appeals should cover both merit (administrative) and judicial review in both gas and electricity codes. The Commonwealth Productivity Commission in all its inquiries into regulatory instruments, including the Draft Report on the *Review of the Gas Access Regime*, has consistently supported this position. The reliance on judicial appeals is also not supported by legal specialists and the Commonwealth Administrative Review Council (ARC).

The Information Paper also states that the AER will take specific gas and electricity-related functions from the *National Electricity Law* and *Gas Pipelines Access Law (GPAL)* and associated regulations and laws. Some states have introduced appeal rights outside the National Electricity Code. For example, the Victorian Essential Services Act provides for appeals from determinations of the state regulator on pricing and other matters on a full merit appeal based on limited grounds.

Any move to national regulation which did not take account of existing state based appeal mechanisms would be inconsistent with best practice regulation and may lead to a diminution of appeal rights.

In jurisdictions where private capital has been invested in reliance upon existing appeal rights, to remove them now would fundamentally infringe the principles of independent regulation upon which investment decisions were made.

The companies seeks *specific* confirmation that proposed national arrangements would operate to preserve existing avenues of administrative/merits appeals contained in current third party access regimes (for example, appeal mechanisms specified in Sections 38-39 of *GPAL*) and in relevant state legislation.

In a key address the Chairman of the Productivity Commission outlined the value of an efficient and effective appeal system:

"A related issue to determining the right thresholds for regulatory action is that where the potential costs of regulatory action are high there should be the capacity for verification that the right diagnosis has been reached. Different competition regimes in Australia have different standards of accountability.

For example, in the national access regime under Part IIIA, declarations are appealable to the Australian Competition Tribunal, whereas under the telecommunications access regime in Part

XIC, no appeal rights exist for declaration at this stage. As evidenced by the Duke decision, regulatory error can occur, with the Tribunal as a useful second umpire”¹

Any removal of existing administrative/merits appeal provisions would be inconsistent with both the findings of, and government responses to, the Productivity Commission’s *Review of the National Access Regime* and the Commission’s recent draft recommendations in the *Review of the Gas Access Regime*.

Uncertainty over key elements of future appeal arrangements has the potential to undermine the achievement of the MCE’s objective of enhancing the framework for accountability of energy market regulation and the facilitation of future investment in the energy sector.

Legal commentators have also warned about the return to judicial review without the use of merit (or administrative appeal) as not being best practice regulation. Whilst the issue in the quotation below deals with the private contracting of government services the points remain valid for regulated assets:

“The effect of removing or shrinking access to merits review and the other administrative law remedies could result in a partial return to the situation that existed prior to the introduction of the administrative reforms. Individuals adversely affected by decisions relating to government services must in such situations seek remedies from the courts which are by no means straightforward to establish nor inexpensive to assert. This is not to deny that there are other avenues for redress that can provide service recipients with a means of challenging the decisions of contractors.....

The difficulties that individuals face in seeking to challenge decisions of contractors is only one of the negative consequences that flow from not maintaining the universality of a right to merits review. A further negative consequence of general significance for the community is the absence of one of the established mechanisms for the systemic review of the decision making system. As the ARC has noted, private law remedies do not provide the same type of feedback and enhancement of decision making and accountability that is provided by the administrative law remedies.”²

2. The Differences between Merit (Administrative) and Judicial Appeals

A merits (or administrative) review is a review of a decision on the merits. Merits reviews are undertaken by a review tribunal and the process can be described as ‘stepping in the shoes’ of regulators and other decision-makers and determining what is the ‘correct and preferable decision’. Appeals against a decision of the Trade Practices Act are to the Australian Competition Tribunal (ACT). Under the National Gas Code there is a full merit appeal on limited grounds.³

¹ See Gary Banks, Chairman Productivity Commission, “Regulating Australia’s Infrastructure: Looking Forward”, Presentation to the Financial Review and AusCID National Infrastructure Summit, Melbourne 14-15 August 2002, p.10.

² O’Connor, D (Justice) 2000, Lessons from Past/ Challenges for the Future: Merit Review in the New Millennium, Presented at the 2000 National Administrative Law Review – Sunrise or Sunset? Administrative Law in the New Millennium www.aat.gov.au/speeches. p.4

³ Section 39 of the Gas Law principally governs the pricing and access appeal arrangements of the gas access regime. It provides that merit appeals may be made on the basis of error of fact; incorrect or unreasonable exercise of discretion; or an exercise of discretion where none exists.

A judicial review is before a Supreme Court or the Federal Court and covers matter such as:

- Procedural fairness;
- A failure of the regulator to take into account all relevant considerations;
- The fact that a regulator has taken into account irrelevant considerations; and
- Making a decision that no regulator acting reasonably could have made.

The reason for the preference for merit appeals for pricing and access decisions is that they are generally not a matter of law or the interpretation of law but are about economic pricing issues and financial and accounting matters. In other words the issues are about the correctness of the decision rather than its legality

3. The Importance of Appeal Rights

Appeal mechanisms play a critical role in administrative and legislative frameworks across society for a number of reasons.

Accountability

The process of review provides an opportunity for decisions by regulators to be scrutinised and challenged. Such a process might increase awareness among decision-makers about the exercise of decision making power, within the terms of authorising legislation.

This issue was clearly demonstrated in a presentation to the Productivity Commission in the Review of the Gas Access Regime where the ACCC Commissioner for Energy and Mergers supported the Commission's proposed extension of full merit appeal provisions into the National Gas Code in a discussion with the Chairman of the Inquiry:

“Mr. Willet:...I must say that since I started with the NCC some eight years ago, one of the things that has really struck me is the discipline that is created on large parts of your work by the fact that you know that work is reviewable by the judicial or quasi-judicial body and you know that when you make findings and you make recommendations that you really need to be in a position to prove those, if a review is called for. In both my life at the NCC and my current life I can tell you that everyone involved in these sorts of matters is very cognisant of the fact that we are likely to have to be able to establish what we're saying to the satisfaction of the Australian Competition Tribunal. ...

Mr. Hinton: A bit like public hearings.

Mr. Willet: Indeed they are a bit like public hearings....We would suggest some changes to the review of access arrangements. There are arguments for a full merits review, rather the partial constrained process that there is at the moment. I am relaxed about that, I must say.⁴

It has also been supported by the Utility Regulators Forum in its Best Practice utility regulation discussion paper of July 1999 (at page 7):

⁴ Transcript of Proceedings, Productivity Commission, Draft Report into Gas Access Regime, Comments by Ed Willet, ACCC Commissioner, At Sydney, 25 March 2004pp.707-708.

Accountability involves regulators taking responsibility for their actions. This requires regulators to establish clearly defined decision-making processes and provide reasons for decisions. Supporting the decision-making process should be effective appeal mechanisms and adherence to principles of natural justice and procedural fairness.

3.1. Protection of property rights

A merit review is desirable given the intrusion of the access regimes on property rights and the freedom to contract.

The Productivity Commission in their review of the National Access Regime commented that:

“As the Commission emphasised in the Position Paper, appropriate protection for property rights must be the pre-eminent consideration in formulating a system of appeal rights for access regimes”⁵

The Hilmer Committee (1993, p. 242) noted that these are fundamental established rights in our legal system and are not to be disturbed lightly. It recognised that protection of these rights was an important concern:

“The Committee is conscious of the need to carefully limit the circumstances in which one business is required by law to make its facilities available to another. Failure to provide appropriate protection to owners of such facilities has the potential to undermine incentives for investment.”⁶

Protection of private property rights was also the paramount concern in the Productivity Commission’s review of the National Access Regime report (PC 2001c). The protection of property rights was also the reason that a merit review was included in the Gas Code. This was not provided for in the National Electricity Code due to the public ownership of such facilities at the time the Code was developed. However, with the privatisation of government owned facilities in Victoria and South Australia it is opportune to include full merit review in the National Electricity Code for the same reasons it was included in the National Gas Code.⁷

⁵ Productivity Commission , Review of the National Access Regime, (September 2001), Canberra p. 396

⁶ Hilmer Committee (Independent Committee of Inquiry into Competition Policy in Australia, chaired by Professor F. Hilmer 1993, National Competition Policy: Report of the Independent Committee of Inquiry into Competition Policy in Australia, AGPS, Canberra, p.248.

⁷ However, even under the relatively restrictive term of a “material error of fact” four of the electricity distributors in Victoria successfully appealed against the 2001 Electricity Price Determination on the basis of incorrect expenditure forecasts by the regulator involving sums of between \$10m-\$200m over the five year regulatory period. This clearly shows the importance of appeal rights to protect the private property rights of regulated businesses.

3.2. Timeliness and A Net Benefit to the Public

The Productivity Commission also outlined their support on cost-benefit grounds for an effective and efficient appeal system:

"While a number of other participants also acknowledged that provisions for merit review of undertakings would involve some additional costs and delays, they contend that these costs would be more than outweighed by the benefits of promoting thorough analysis of the issues at hand. Moreover, some went on to suggest that other mechanisms could and should be used to limit these additional costs. Thus the Australian Gas Association commented that:

Any concerns regarding the timeliness of decision making which arise from the proposal to allow reviews of undertaking decisions should be addressed through tighter rules on decision making not through retaining restrictions on access to merit reviews (sub DR84, p.11)

The Commission agrees with this argument."⁸

3.3. Better decision-making

Appeal processes also promote the consistent application of the law by decision-makers and lead to improvements in the quality of primary decision making. Merit appeals to one appeal body such as the Australian Competition Tribunal can be used to update the legal interpretation of the codes and, through consistent decisions, reduce regulatory uncertainty over time:

And it frees that discretion from effective review by the Courts, which are limited to matters of law, and hence cannot set out clear guidance of the kind the Australian Trade Practices Tribunal (now the Australian Competition Tribunal) has so effectively given in respect of the Trade Practices Act."⁹

In fact supporters of merit (administrative) appeals have argued that:

The administrative law system, when working properly, supplements and enhances the traditional processes of ministerial and parliamentary accountability in our system of government. As the Administrative Review Council (ARC) has stated, the administrative law remedies ensure that the administration is accountable to an individual in respect of its decisions that affect that person. Moreover, administrative law remedies improve the whole system of government decision making by increasing its openness and transparency and providing feedback on its performance. Confident executive government should welcome this kind of audit.¹⁰

3.4. Overall

In summary, robust and effective appeal mechanisms (including both judicial and merits-based review) are critical components of effective third party access frameworks for a number of reasons. Appeal mechanisms:

⁸ Productivity Commission, (September 2001), p. 390-391

⁹ Henry Ergas, NECG "Briefing on Epic Decision", (11 June 2003), p.13.

¹⁰ op cit O'Connor, D (Justice) 2000, p.2

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- improve accountability in regulatory decision-making;
 - assist in the transparency of regulatory decisions and decision-making processes;
 - use consistent interpretations on the regulatory framework to provide more certainty about its application over time;
 - reduce the risks to the community and service providers of regulatory error and failure;
 - recognise the continuing property rights of owners of sunk capital investment especially when regulatory periods are shorter than the technical and economic life of the assets;
 - better support private sector investment in new and existing long-lived capital assets; and
 - the benefits of appropriate appeal processes outweigh their cost to society.

4. The Need for Both Merit and Judicial Appeals

In considering the merits review more specifically, there are several reasons that it is desirable to have a merits review in addition to a judicial appeal. Firstly, a merit review is complementary to a judicial review. As the Administrative Review Council noted:

... the judicial review powers vested in the Federal Court are complementary to, but distinct from, merits review powers. Judicial review involves the exercise of the Commonwealth's judicial power and results in findings of law. Merits review involves the exercise of administrative powers and results in a correct and preferable decision.¹¹

Secondly, an administrative appeal is often a more feasible avenue than a court-based appeal. The complexity and costs of court-based appeals, given the diffuse nature of any potential benefits, make such appeals a relatively unattractive option for users and most other interested third parties.

Thirdly, the Access Regimes create legislative decision making powers for Ministers and regulators. Good administrative law practice sees benefits in having a merits review available whenever a legislative enactment creates a decision making power, especially where decision making bodies have discretionary powers (as is the case under the Gas Access Regime)¹².

A decision made under the Gas Access Regime involves both procedural and judgemental elements. That is, when the correct procedures and processes are followed, the decision-maker still exercises an element of judgment. There is a risk that an error will be made. The Kerr Committee noted that having a merits review available does not:

“... suggest that there is any propensity to err in the administrative process, although without doubt error does occur. It is the possibility of error that demonstrates the need for review.”¹³

¹¹ Administrative Review Council 1999, What decisions should be subject to a merit review? www.law.gov.au/www/arcHome. Para 5.31

¹² Op cit O'Connor, D (Justice) 2000.p. 3-4.

¹³ Kerr Committee 1971, Report of the Commonwealth Administrative Committee, AGPS Canberra, p.3.

5. The Current State of Appeals in Australia for Regulated Utilities

The companies do not consider that the current energy codes governing energy utilities in Australia has provided an adequate model for appeal rights on the basis that

- Appeal rights differ between transmission and distribution networks;
- Appeal rights differ between electricity and gas; and
- Appeal rights differ between states and territories.¹⁴

Current appeal mechanisms are inconsistent between jurisdictions and between energy industries, and the right to full merits-based review is effectively not available for pricing decisions in the energy industry as shown in the Table below.

¹⁴ Judicial appeals were originally established under the Code to the Federal Court. However with the constitutional challenge to the states access to the Federal Court judicial review is now undertaken by the relevant state Supreme Court. However, the Commonwealth and Northern Territory Application Acts still use the Federal Court for judicial review. The recent appeal by EPIC to the WA Supreme Court on the basis of a draft decision is an example of a judicial review on a matter of law

**Appeals under the National Gas Code (NGC) and the
National Electricity Code (NEC)**

Company Type	Appeal Grounds for Regulatory Decisions for Energy Utilities
Gas Transmission	Merit appeals to the Australian Competition Tribunal (except in WA) but with limited grounds under the Gas Pipelines Access Law appeal provisions (S.39).
Electricity Transmission	Judicial review on pricing determinations to the relevant Supreme Court (or Federal Court) and some limited administrative appeals under the National Electricity Code.
Gas Distribution	Merit appeals to state regulators, except in NSW, but with limited grounds under the Gas Law appeal provisions (S.39).
Electricity Distribution	Appeals to state Supreme Courts or Federal equivalents unless covered by state legislation such as in Victoria where there is a full merit appeal (on limited grounds) to an appeals panel). Some limited administrative appeals under the National Electricity Code.
Coverage under the National Gas Code	Appeals under the Gas Pipelines Access Law under S.38 with full merit appeal rights.

These divergences in appeal processes undermine the goal of a nationally consistent access regime that should offer consistent appeal mechanisms across all assets regulated under the energy regulatory regimes. If the MCE process adopts the proposal that only existing code powers will be utilised in the new national approach the new approach will not be nationally consistent as:

- The appeal powers under the National Gas Code are more extensive than under the National Electricity Code and include merit appeals;
- The merit appeal powers under the National Gas Code will not be available to the gas industry if the MCE adopts the principle that only “judicial” reviews are to be permitted; and
- State based merit appeal arrangements will be disenfranchised under a move to a national framework if the MCE only adopts the appeal arrangement currently existing in the relevant codes

In addition, an appeal structure based on full merit review and judicial appeals represents best practice regulation that should be the objective of the national approach to energy regulation.

A final element of an effective and efficient merits appeal arrangements is the capacity for an appeals body to implement its findings. To allow this, merits appeal arrangements should allow the primary decision to be either:

- affirmed in full;
- set aside to be remade by the primary decision-maker; or

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- varied according to findings of the merits review body.

For this to be possible, the merits review body should be in a position to exercise all the powers and functions of the primary decision-maker, and substitute its decision for that of the primary decision-maker.

6. The Effectiveness of Judicial Review?

The Information Paper notes that the MCE will have the power to issue policy direction to the AEMC and AER. Judicial review will be severely hamstrung if that power is exercised in such a way that the AEMC and AER effectively exercise no discretion, which could be the subject of review, but are simply compelled to do the bidding of the jurisdictions.

The companies seek an assurance that the empowering provision in relation to the giving of direction will be expressed in general terms in relation to policy matters so it cannot be interpreted to allow a jurisdiction to direct how a particular matter should be decided.

7. Recommendation on Appeal Rights

That the following principles be used to ensure best practice regulation is used in the development of the new national regulatory model for appeal rights in the gas and electricity industries:

- Principle 1 – existing appeal rights be preserved to protect the environment in which private investment decisions were made;
- Principle 2 - access to full merit appeals and judicial reviews for owners of energy assets for price determinations and any other regulatory decision affecting revenues or costs;
- Principle 3 – making all merit reviews to the Australian Competition Tribunal (ACT) in the new national regulatory model;
- Principle 4 - an ability on the part of the ACT to set aside, vary, or substitute their own decision for that of the original decision, and to exercise all the powers and functions of the original decision-maker.
- Principle 5 – a capacity to appeal against regulatory decisions made during the access period that impacts on the revenue or costs of the distributor and on draft and final pricing decisions.