Economic Regulation Authority

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Dear Secretariat Manager

Submission on the Stage Two Report of the Review of the Limited Merits Review Regime

Thank you for the opportunity to provide comment on the recommendations of the final Stage Two report of the Review of the Limited Merits Review (**LMR**) Regime (the **Yarrow review**).

The Economic Regulation Authority (**ERA**) is the regulator of third party access regimes for electricity and gas infrastructure in Western Australia (refer to **Attachment**). The ERA and the Australian Energy Regulator are the regulatory bodies whose decisions have been subject to the existing LMR and Judicial review processes.

It is clear that the economic regulation of natural monopoly infrastructure in Australia is at a critical point in its development, due to the substantial increases in electricity prices and the various concerns about perceived failures of the existing arrangements. It is at times like this that legislators looking for solutions need to exercise extreme caution before embarking on change; policy proposals that may appear attractive may be found at a later stage to not be effective because of a lack of rigour in problem definition and in the analyses of alternative approaches.

The Yarrow review's recommended changes are premised on the need to ensure that regulatory decisions better serve the long term interests of consumers. The ERA agrees that the regulatory framework would be strengthened by enshrining the long term interests of consumers in the objectives of the National Gas Rules (**NGR**) and revenue and pricing principles.

However, the ERA is concerned that the other recommendations of the Yarrow review have not been substantiated.

Before abandoning an existing institutional framework one would expect due consideration of a range of options ranging from minor incremental changes to the more substantive changes being proposed by the Yarrow review. Best practice policy formulation would require a robust analysis of the various alternatives in order to arrive at a sound basis for change.

The ERA considers that the Yarrow review has not justified that such a major change in institutional structure for the review process is warranted. The evidence relied upon is at best speculative and certainly not a sound basis for such a fundamental change. In fact the ERA considers there is evidence that supports the existing arrangements, as demonstrated in the recent Australian Competition Tribunal access arrangement appeal decisions for ATCO Gas

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Networks and the Dampier to Bunbury Natural Gas Pipeline against the decisions of the ERA.

The ERA shares some of the concerns that prompted the Yarrow review, such as the opportunity the existing LMR process provides for service providers to cherry pick. However, the Yarrow review has not demonstrated that a move away from an error correction framework would better serve the long term interests of consumers. In practice, it is likely that service providers would, in the event that the Yarrow review proposals are implemented, continue to raise the same issues (largely to do with components of the rate of return) that have been raised in the past and the review body would need to analyse these in a similar way as now occurs.

In this context, the ERA notes that the current regime – for which there is now an established and considerable body of precedent – could be enhanced by anchoring it on the long term interests of consumers. Adjusting the existing arrangements to these ends would be far preferable to venturing into unknown territory through the establishment of the Australian Energy Appeals Authority (**AEAA**).

The proposed change would see a move away from the legislative regime under which the regulator has made its decision through to a review regime that arguably is capable of adopting its own standards to assess whether a better alternative exists. The ERA is strongly of the view that the recommended AEAA solution presents major regulatory risk and undermines the role of the primary regulator who operates in a legislative based rules framework whereas the AEAA appears largely unfettered and unaccountable.

Further, the ERA is concerned that the AEAA would be a body attached to the Australian Energy Markets Commission (**AEMC**) and would be using AEMC people who write the rules, so there is an immediate issue of conflict given the relationship between the rule maker and judge.

Furthermore, the recommendations relating to a single ground of appeal on the basis of a materially preferable decision, which is then subject to an investigative approach open to the participation of all parties, are problematic as there is every prospect that no two bodies will see things in the same light and there is a real prospect that by its very existence the AEAA will be inclined to find a "better"/"preferred" outcome for consumers. The ERA considers the current grounds for appeal, which essentially require that it be demonstrated that the original decision maker made an error of fact or exercised its discretion incorrectly or the decision maker failed to reasonably consider the facts and evidence, are a more robust basis for establishing the need for a merits review.

A significant concern for the ERA would be the potential for the AEAA to broaden the scope of the review to such an extent that it becomes a 'de novo' review. The panel's recommendation to modify the law objectives with the words "in ways that best serve the long term interests of consumers", is problematic particularly if it resulted in a move away from a primacy relating to economic efficiency that best serves the long term interests of consumers. There is a risk that matters such as correcting distributional concerns, that may be considered to serve the long term interests of consumers but which are not related to efficiency in a competition policy sense, will be construed as being part of the national laws' objectives or the revenue pricing principles.

The ERA is supportive of the recommendation, for some limited relaxation on the time constraint on the merits review process. However, the ERA considers that it is important that time be limited, as an incentive to avoid 'de novo' review. The ERA has significant

concerns that there may be a drift towards the latter. A four to six month timeframe would help to avoid such a drift.

The ERA also notes that the merits review process has served to clarify the interpretation of the National Electricity Law and the National Gas Law and subordinate instruments and is concerned that this important element of the judicial nature of the existing LMR regime appears to have been given cursory attention. The investigative approach of the proposed AEAA is unlikely to provide the same authoritative/precedential value from reviews as it would merely be a second and final opinion.

The ERA understands that the AEMC is currently pursuing a number of changes to the National Electricity Rules and National Gas Rules. To the extent that changes to the LMR regime may have been relevant in formulating the scope or nature of the proposed rule changes there may be a need to reconsider these in light of the concerns that the Yarrow review has not clearly established its case for such substantial change.

Should you have any questions regarding any of the above matters please referred them to Mr Robert Pullella, Executive Director Access (08) 6557 7900.

Yours sincerely

LYNDON ROWE
CHAIRMAN

26/10/12

cc Hon. Peter Collier MLC, Minister for Energy, Western Australia

BACKGROUND

The ERA's role in relation to gas access is governed by the National Gas Law and National Gas Rules. The ERA's functions in this regard are similar to those of the Australian Energy Regulator, and relate to third party access to covered pipelines in Western Australia, which includes the Dampier to Bunbury Natural Gas Pipeline, the Goldfields Gas Pipeline and the Mid-West and South-West Gas Distribution Systems. The Kalgoorlie Kambalda pipeline is subject to light-handed regulation.

In line with the arrangements under the National Gas Law (**NGL**) and National Gas Rules (**NGR**), the ERA's decisions are subject to Limited Merits Review (**LMR**) by the Australian Competition Tribunal (**ACT**). These arrangements have been in place in Western Australia since 1 January 2010. Prior to that time, the ERA administered the *National Third Party Access Code for Natural Gas Pipeline Systems* in Western Australia – as subordinate legislation under the *Gas Pipelines Access (Western Australia) Act 1998.* LMR under that process involved review by a State-based Gas Review Board.

Western Australia has its own law relating to electricity networks access, which is governed by the *Electricity Networks Access Code 2004* under the Government of Western Australia's *Electricity Industry Act 2004*. These arrangements are also subject to a review process which is similar to the LMR process. Applications for review under the Act are heard by a State-based Electricity Review Board which is constituted when an application for review of a decision is lodged.