Economic Regulation Authority

Our Ref: TRIM Ref. D90665
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Attn: Review of Limited Merits Review Secretariat
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By email

Dear Professor Yarrow

Submission to the Review of the Limited Merits Review regime

Thank you for the opportunity to provide comment on the issues raised by the Review.

The Economic Regulation Authority (**ERA**) is the regulator of third party access regimes for electricity and gas infrastructure and approval of access arrangements in Western Australia.

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.

A number of the ERA's decisions relating to gas have been subject to LMR or judicial review, as follows:

- The Dampier to Bunbury Natural Gas Pipeline (**DBNGP**) Draft Decision for the first access arrangement in 2001 was subject to an application for judicial review by the owner at that time, Epic Energy. The matter was heard by the Western Australian Supreme Court of Appeal. The Court did not issue the prerogative relief sought but made declaratory orders and remitted the decision back to the ERA as Regulator to

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make a Final Decision taking into account the Court's declarations. The Court's declarations related to interpretation of the *National Third Party Access Code for Natural Gas Pipeline Systems* as it pertained to the establishment of the initial Capital Base and the manner in which section 2.24 (factors to be considered when approving an access arrangement) ought to be construed.

- In 2001 there was also an application for judicial review by the owners of the Goldfields Gas Pipeline (**GGP**) with respect to the ERA's Draft Decision on the proposed access arrangement for the GGP. GGP's application was subsequently discontinued.
- In 2003 WMC Resources Ltd, a user of the GGP, sought judicial review of the Regulator's decision to consider the effect of the State Agreement ratified by the *Goldfields Gas Pipeline Agreement Act 1994* on the application of the Code to the GGP. The Supreme Court ordered declaratory relief to the effect that, contrary to the submissions of the then owner of the GGP, the State Agreement and the *Government Agreements Act 1979* did not prevent the regulator from applying the Code to the GGP.
- In 2004, the service provider of the DBNGP pipeline applied for review of the Regulator's Final Decision before the Gas Review Board (pursuant to *Gas Pipelines Access (Western Australia) Act 1998*). The application was withdrawn before being concluded. This coincided with the sale of the pipeline and the new owners deciding not to proceed with the appeal. The matter commenced in January 2004 and was terminated later that year.
- There was a further appeal by Western Power Corporation (a user of the DBNGP) in 2005 regarding the Regulator's Final Decision on the proposed revisions to the access arrangement for the DBNGP. The appeal was heard but discontinued before the Gas Review Board handed down its decision.
- In 2010 Goldfields Gas Transmission Pty Ltd applied for review of the Regulator's approved access arrangement revisions which were assessed pursuant to the old *National Third Party Access Code for Natural Gas Pipeline Systems*. This matter was heard by the Electricity Review Board (**ERB** - formerly the Gas Review Board) and a decision was handed down on 22 November 2011. Orders were made to recalculate the tariff that would apply – assuming a later commencement date for the access arrangement. The ERB requested the Regulator to recalculate tariffs taking into account necessary adjustments for over- or under-compensation as a result. In addition, the parties were asked to propose a form of wording for the Extensions Expansions Policy so as to give effect to the Board's decision and reasoning.
- On 8 June 2012, the ACT handed down its orders on ATCO's and Alinta's applications in relation to the ERA's decision on the Mid West and South West Gas Distribution System Access Arrangement.

  ATCO as owner had taken over the appeal from the former owner of the pipeline, Western Australian Gas Networks Pty Ltd (**WAGN**). ATCO's grounds of the appeal related to seven main issues:

  - the application by the ERA of rule 87 of the NGR, relating to the 'construction' of the rate of return in terms and the ERA's use of the Capital Asset Pricing Model (**CAPM**);

- specific errors relating to the determination of the market risk premium, gamma, and the debt risk premium in the CAPM and debt raising costs;
- the application of escalation to account for inflation in relation to the capital base;
- the allowance for bridging finance;
- the allowance for working capital;
- tariff variation to account for government regulatory intervention during the regulatory period; and
- the proposed template haulage contract.

With regard to the ATCO application, the ACT made orders that the decision be remitted back to the ERA for the purpose of making the decision again, but limited to giving effect to the ACT's declarations on the gamma, the application of the bond yield approach, the allowance for bridging finance, the form of tariff variation and the template haulage contract terms and conditions.

Alinta's grounds of appeal with regard to the ERA's decision on the Mid West and South West Gas Distribution System Access Arrangement related to an alleged failure of the ERA to take into account the possible impact of the proposed tariffs on small users, or to mitigate that impact through gradual introduction of higher tariffs. On this matter, the ACT found that the ERA had not committed any error and affirmed the ERA's decision.

Currently, there is one gas LMR matter on foot with the ACT:

- Dampier to Bunbury Pipeline's application for review of the ERA's decision on the DBNGP Access Arrangement.

Given that the DBNGP matter is still before the ACT, the ERA is limited in what it can say. For this reason, statements in relation to the LMR as it stands are confined to matters of fact. In addition, any statements made in relation to potential changes to the LMR regime should be read as suggestions for the Review's consideration, not as criticisms of the current regime.

With these caveats, we consider the topics identified in the issues paper in what follows.

The policy intent

The ERA agrees that there is a need to provide a Regulatory framework that promotes the efficient investment in and use of energy infrastructure, such that regulatory decisions provide a balanced outcome between competing interests and protect the property rights of all stakeholders. An important part of balancing these interests is allowing parties affected by decisions to have appropriate recourse to a process for review of decisions.

The ERA also agrees that appropriate review mechanisms should aim for optimal decisions achieved within a framework where the benefits of the review outweigh the costs to stakeholders.

The ERA notes that the criteria set out in the Ministerial Council on Energy's document Review of Decision-Making in the Gas and Electricity Regulatory Frameworks identified that an appropriate review scheme would contribute to:

- maximising accountability;
- maximising Regulatory certainty;
- maximising the conditions for the decision-maker to make a correct initial decision;
- achieving the best decisions possible;
- ensuring that all stakeholders' interests are taken into account, including those of service and network providers, and consumers;
- minimising the risk of "gaming";
- minimising time delays and cost.

The ERA considers that these criteria are appropriate and necessary.

The ERA notes that the purpose of the LMR is to determine whether the Regulator erred, given the facts before it at the time the Regulator's decision was made. In this context, the ERA notes that the gas law requires that applicants clearly establish the nature of the specific error or errors alleged. Specifically, section 246 of the NGL states that:

> Grounds for review
>
> (1) An application under section 245(1) may be made only on 1 or more of the following grounds:
>
> (a) the original decision maker made an error of fact in the decision maker's findings of facts, and that error of fact was material to the making of the decision;
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> (b) the original decision maker made more than 1 error of fact in the decision maker's findings of facts, and 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.
>
> (2) It is for the applicant to establish a ground listed in subsection (1).

The ERA considers that the elements in section 246(1)(a) and (b) are straightforward and amenable to clear reasoning. The ERA notes that section 246(1)(c) and, particularly, section 246(1)(d) are more open to interpretation. A broad interpretation of these latter elements could result in the LMR gravitating towards a full merits review process in the subsequent review, which is not the policy intent. On the other hand, a judgment by the ACT that substituted only a partial discretion or decision – based on grounds for review that were limited in scope – could equally be problematic, as it may not account for the full consideration of the Regulator.

The difficulty with subsections 246(1)(c) and (d) is that if a reviewable error is found to have occurred, it is open to the ACT to vary the decision pursuant to section 259(2).[1] Save where the matters relevant to the exercise of the Regulator's discretion are strictly limited, the ERA is concerned that it is very difficult for the ACT to ensure that all the matters pertaining to the full decision are taken into account where material error, incorrect discretion or unreasonable decision is judged to have occurred. In such a case, the ERA is of the view that it is generally preferable that the matter be referred back to the Regulator, with guidance as to where the Regulator erred. This enables the full range of relevant considerations to be brought to bear in the exercise of the discretion, and a reasonable decision to be made, informed by the ACT's declarations or recommendations.

As a final related point, the ERA considers that a decision of the ACT should not be based on additional information, which was not made available until after the Regulator's Final Decision. This issue is discussed in greater detail below.

Structural influences on the performance of the regime

The ERA is aware of instances in the LMR process where service providers have submitted information relevant to regulatory decisions only very late in the process, even after the Final Decision has been made by the Regulator. In some instances information received after the Final Decision may be in response to new information relied on by the Regulator, but more often late submissions relate to matters or issues previously before the Regulator for which ample opportunity was afforded to the affected parties to raise any concerns.

For example, during the ERA's Final Decision on the Mid West and South West Gas Distribution System Access Arrangement, the ERA received letters of submission after the Final Decision, but prior to publication of a substitute access arrangement drafted by the ERA (the latter being the Reviewable Regulatory Decision). Late submissions were received from Alinta, relating to the impact on its business of the proposed tariff path, and from the service provider WA Gas Networks (**WAGN**), now ATCO (a summary by Talbot Olivier of these items is available on request).

With regard to the letter from Alinta, the ACT made the following observations in its recent decision of 8 June 2012:[2]

> 82 As to the [Alinta] submission of 22 March 2011, the question arises as to whether that submission is review related matter, so that the Tribunal may have regard to it in accordance with s 261(1) and (7) of the NGL.
> 83 It appears to have become a matter of increasing importance in reviews conducted by the Tribunal to determine the extent of "review related matter" under s 261(1) and (7) of the NGL. The issue arises in circumstances like the present, where the regulator has completed the process of a Draft Decision and a Final Decision as contemplated under Division 8 Part 8 of the NGR specifying the procedure for dealing with a full access arrangement proposal. Rule 62(7) and (8) of the NGR fix the time after receipt of the access arrangement proposal by which the Final Decision must be made. Then, if the regulator refuses to approve the access arrangement proposal (or its revision), it must under Division 9 propose the access arrangement itself within a further two months: rule 64(1) and (4); rule 64(3) provides that the regulator may (but is not obliged to) consult on its proposal. The decision of the regulator

[1] Section 259(2) of the NGL states: 'A determination under this section may—
(a) affirm, set aside or vary the reviewable regulatory decision;
(b) remit the matter back to the original decision maker to make the decision again, in accordance with any direction or recommendation of the Tribunal.'

[2] Australian Competition Tribunal 2012, *Decision*, Application by Alinta Sales Pty Ltd (no 2 [2012] ACompT 13, p. 20.

under rule 64 then becomes the "Reviewable Regulatory Decision" under Part 5 of Chapter 8 of the NGL.

84 Putting aside the discretion of the regulator under rule 64(3) of the NGR, the time constraint imposed by the rule 64(4) means that the regulator may have little or no time to consider or to consider carefully any material - whether submissions or information or expert opinion or otherwise - received by the regulator prior to the Reviewable Regulatory Decision. Such material may be extensive. It may be belated, even understandably so if it has required significant preparation time. It may invite a dramatically different approach to that expressed in the Final Decision.

85 In such circumstances, it does not appear to fulfil the purpose of the process prescribed in Divisions 8 and 9 of Part 8 of the NGR that the regulator's Reviewable Regulatory Decision might be exposed to apparent error (as defined in the grounds of review ins 246(1) of the NGL) by reason of material it did not have any real opportunity to consider and take into account. That is especially so as rule 64(3) provides that it need not consult beyond the Final Decision point in relation to its Reviewable Regulatory Decision and its access arrangement proposal made by that decision. On the other hand, a party affected by a potential decision reasonably may not be aware of the potential adverse consequences to it until the Final Decision and then have little or no opportunity, and (if the ERA is right), no entitlement, to endeavour to have the ERA consider its concern. In an appropriate circumstance, that question will have to be considered by the Tribunal.

86 In this matter, the Tribunal does not need to go beyond the apparently clear words of s 261(7)(d): the submission of 23 March 2011 is apparently a "written submission made to the [ERA] before the reviewable regulatory decision was made". It is not necessary to further explore that question because the submission does not really raise, except in more forceful terms, what had previously been put to the ERA, and to the extent that it conveys additional information (ie the media report of a statement by the Premier) that information does not persuade the Tribunal that the ERA committed reviewable error in terms of s 246(1) if the Tribunal were otherwise not persuaded of error on the part of the ERA.

The ERA notes that the ACT acknowledges, at paragraphs 84 and 85 of its decision, that there is an issue in relation to the definition of 'review related matter', although the ACT determined in the ATCO decision that section 261(7)(d) of the NGL is clear that material received prior to the Reviewable Regulatory Decision including late submissions is admissible as review related matter.[3]

The ERA notes that there is a tension between section 261(7)(d) of the NGL and Rule 64(3) of the NGR. Specifically, the NGR provides that the Regulator may (but is not obliged to) consult. On the other hand, the NGL allows any material received prior to the Reviewable Regulatory Decision to be admissible evidence for a subsequent LMR, regardless of whether it has been a part of a public consultation process conducted by the Regulator. This tension is alluded to, but not resolved, by the ACT in paragraph 85 of the ACT's decision quoted above.

The ERA is concerned that the tension in this aspect of the operation of the NGL and NGR may be an unintended consequence of amendments made to the LMR process. The ERA understands that the original intent of the SCER in making the Reviewable Regulatory Decision the approved access arrangement decision subsequent to the Final Decision was because it was intended that an access arrangement (including revised tariffs) should take effect notwithstanding the lodgement of an application for review. The rationale of this approach was to avoid incentives to delay the commencement of an approved access

[3] In WA Gas Networks Pty Ltd (No 2) [2011] ACompT 15, the ACT confirmed that a final decision that does not approve a full access arrangement submitted by the applicant is not a Reviewable Regulatory Decision.

arrangement until after a review application was heard and determined (an incentive and process that was apparent under the prior regulatory arrangements).[4]

The ERA considers that section 258 provides some guidance as to how the tension between the NGL and NGR should be resolved.[5] The ERA is of the view that an important objective of subsection 258(2) is to ensure that all relevant matters to an access arrangement are raised prior to the ERA's decision, and subjected to the public consultation process under the NGR. The corollary is that matters should not be raised for the first time before the ACT. Publication of submissions and consultation is an important aspect of the process, encouraging transparency and ensuring that procedural fairness is afforded to all parties affected by the decision. An important outcome of such an approach is to improve the quality of decision-making at the first instance and the efficiency of the decision-making process overall.

In a similar vein, an issue arose in the ATCO proceedings with regard to the ability of the ACT itself to introduce a matter in review proceedings giving rise to a possible reviewable error, not being a matter 'fairly arising out of' submissions made by the applicant for review.[6] For similar reasons to those outlined above, the ERA is of the view that it is not consistent with the policy and intent of sub-section 258(2) for any substantive issue to be raised by the ACT after the ERA's Final Decision, unless such a matter has been fairly raised before the Regulator's Final Decision.

The ERA considers that DBP also provided significant new material after the Final Decision of 31 October 2011, but prior to the reviewable regulatory decision of 22 December 2011 (or 12 January 2012 with corrigenda). The ERA published a notice on 1 December 2011 inviting submissions on proposed amendments to its Final Decision – which was necessitated by the passing of the Commonwealth Government's Clean Energy Bill after the Final Decision and the resulting impact of a carbon price on operating expenditure, and also by further consideration with regard to its Final Decision on the proposed extension and expansion requirements for the Dampier to Bunbury Natural Gas Pipeline.

In addition to the proposed amendments to the ERA's Final Decision – which were the subject of the notice of 1 December 2011 – DBP's submissions in December 2011 addressed a range of other matters, including matters relating to the rate of return, forecast capital expenditure and terms and conditions. The ERA would be concerned if, by allowing consultation in respect of the ERA's proposed narrow amendments in the notice, the ERA 'opened the floodgates' in relation to broader submissions on all matters contained in the Final Decision. This matter is currently before the ACT.

In summary, the ERA considers that for the LMR to operate as intended, the basis for establishing an error, discretion or decision under the LMR must hinge only on information that has been available to the Regulator when making its decision, that has been

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[4] Ministerial Council on Energy Standing Committee of Officials 2005, *Discussion Paper: Review of Decision Making in the Gas and Electricity Frameworks*, www.ret.gov.au, Section 5.10.

[5] Section 258(2) provides that 'a party (other than the original decision maker) to a review may not raise any matter that was not raised in submissions in relation to the reviewable regulatory decision before that decision was made'. Section 258(2) limits the jurisdiction that is able to be exercised by the ACT in a review. The intent of the sub-section 258(2) is to limit the arguments and issues that can be raised before the ACT to those arguments and issues that were agitated before the decision-maker during the decision making process. A similar intent was involved with the previous section 39(2) of the Code (specifically, see for example, Epic Energy South Australia [2002] ACompT 4 at [24]).

[6] Specifically, the ACT made an order in relation to the bond yield approach (which was the subject of the grounds for review). The ACT endorsed the ERA's bond yield approach as reasonable. However, the ACT directed that the ERA utilise a different bond averaging approach to that set out in the ERA's Final Decision.

communicated through submissions as part of the Regulator's process prior to the Final Decision.

The ERA believes strongly that there should be no incentive created to withhold information prior to a Final Decision. To do otherwise provides regulated entities and stakeholders with a significant opportunity to game the regulatory process – an outcome that would be clearly at odds with the policy intent of the LMR.

It would appear worthwhile therefore for the Review to consider clarifying under what circumstances late submissions are acceptable, and on what grounds they should be considered. The ERA's view is that late submissions should only be acceptable in relation to substantive changes made by the Regulator at, or after the Final Decision.[7] However, these submissions, and hence the admissibility of any new material, should be limited to the substantive change.

Finally, the ERA is concerned that tight time constraints on the review process could be creating problems for considered engagement by stakeholders in the LMR process. This would be more likely to occur where stakeholders have only limited time to review information. New information that is presented by the applicant at the time of the LMR, or was subject to confidentiality claims, may create particular problems in this context. This adds further support to the notion that only previously available information should be allowed in support of establishing grounds for appeal.

Furthermore, the ERA notes that perceived barriers to participation by stakeholders could be contributing to a climate of smaller 'downside risk' for service providers in LMR than 'upside reward'. Barriers to participation are discussed further below.

Conduct of the ACT

The ERA is not in a position to comment on the conduct of the ACT.

Conduct of the Regulator

The ERA considers that there is limited scope for the Regulator to be able to widen the review through section 258(1) of the NGL by raising matters not raised by the applicant or an intervener. Section 258(1) of the NGL provides for the same action by the Regulator as section 71O of the National Electricity Law. This is because:

- Absent new information, one would expect that matters that could potentially be raised by the Regulator as 'a matter not raised by the applicant' would need to be matters that have been included in the reasoning of the original decision. However, this could require the Regulator to undermine its own arguments made in its Final Decision.
- Furthermore, it is difficult, at the outset of an appeal, for a Regulator to comprehend the full import of any such alternative matters on subsequent proceedings and their potential bearing in the context of any other matters raised. Pursuing such a course of action could lead to a lengthy and resource intensive process and require a significant re-evaluation of the grounds raised by the applicant.

[7] Procedural fairness suggests that if the Regulator made a substantive change at the Final Decision – with regard to an issue or position that was not raised in the Draft Decision – then parties should be allowed to make submissions on the substantive change. If it was accepted by the LMR that a substantive change had occurred at the Final Decision, then the material in these late submissions could be admissible for the LMR.

- There may be difficulties due to time constraints and a lack of understanding of the import of new information. As noted above, the ERA considers that new information should be disallowed in the LMR process.

- The Regulator's role in the LMR is to provide assistance to the ACT – that is, to act as a 'friend of the court'. This is an extension of the Regulator's role as decision maker – which is to balance all interests and considerations in order to meet the objectives of the National Gas Law. While the Regulator can and does defend the balance of its reasoning, this is different to being a contradictor on a matter. As a related point, the ERA notes that, absent a contradictor on a matter, this impartial role leads to the Regulator's Final Decision being a base if the matter is not remitted back to the Regulator. In this case, the ACT has either accepted the Regulator's decision, or else ordered a change that is in the applicant's favour. This point reinforces that made above in relation to the potential asymmetry of risk for an applicant.

- The opportunity for the ACT to remit a matter back to the Regulator for reconsideration could be prejudiced by the Regulator taking on an adversarial role during any review hearing, even in circumstances where there is no other intervener or proper contradictor.

The ERA considers that it would be useful for the Review to provide guidance on these potential conflicts for Regulators.

Participation of network users and energy consumers

The ERA considers that many stakeholders, other than the Regulator and the service provider, have only limited capacity to engage effectively in an LMR process. This is because the volume of information and the level of expertise required to understand the issues sufficiently creates a significant barrier to effective engagement as a contradictor. The cost of having appropriate expertise on hand is beyond many smaller third parties who might consider contributing to a review process.

Furthermore, stakeholders may not have access to all relevant information – as it is often confidential and not accessible prior to leave being granted to intervene in an application for review. Yet such information is likely to be crucial for decision making about whether, or to what extent, a party may wish to intervene or raise a matter on review. As a related point, a lack of 'history' in the process and understanding of the resulting nuances means that even a sophisticated stakeholder may be at a permanent disadvantage in seeking to become an effective contradictor.

A further problem arises where the benefits of successful contradiction are spread among many parties. This means that there may be significant externalities to the participation by a single party. Yet the incentives for 'free riding', and potential transaction costs of coordination even absent 'free riding', mean that it is difficult to ensure the engagement of all affected parties. These elements may be discouraging stakeholders from participating in the LMR process, even where the expected value of any future benefit outweighs the costs. As a result, unlike for the service provider, the cost for an individual party of engaging in a complex review application may exceed the benefits, even though there may be a net benefit to the economy from successful contradiction on the matter.

Time pressure is also a barrier, as noted above. The ACT appears, understandably, to be very mindful of meeting prescribed time limits for hearing review applications. In some

cases, concurrency of matters further constrains available time lines. These time pressures may affect the ability and effectiveness of proper intervention in matters under review.

I trust these comments are useful. I apologise for the lateness of this submission – however, it was useful to conclude the ATCO application prior to making the submission.

Yours sincerely

LYNDON ROWE
CHAIRMAN

21/6/12