The involvement of consumers in reviews by the Australian Competition Tribunal of AER revenue determinations

Presentation to the ACCC Regulatory Conference

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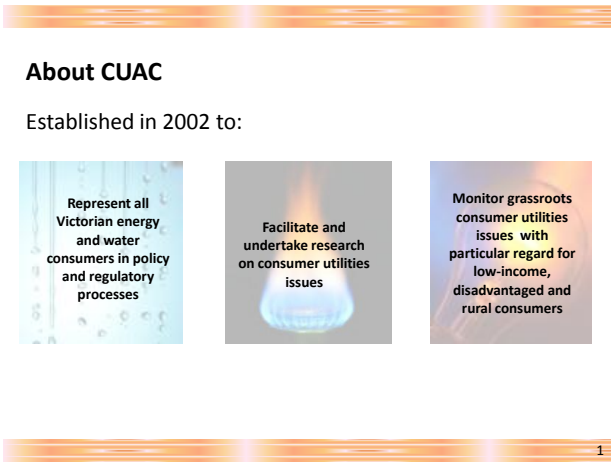
Good morning

It was with great pleasure that I accepted the invitation from the ACCC to speak at this forum. It is widely regarded as Australia's pre-eminent forum on regulation and its practice and it is exciting to be able to represent the views of consumers to the delegates today. And I would like to encourage the ACCC to consider including more consumer views in future programs. My organisation, the Consumer Utilities Advocacy Centre or CUAC sees it as crucial that regulators and regulated industries make greater efforts to include consumer voices in the array of debates and discussions that occur at forums such as this.

Slide 2 – About CUAC



Before I commence my discussion of the merits review and CUAC's involvement in that process, I should give some background as to who we are. CUAC is a specialist consumer organisation established in 2002 to represent Victorian energy and water consumers in policy and regulatory processes. As Australia's only consumer organisation focused specifically on the energy and water sectors, we have developed an in-depth knowledge of the interests, experiences and needs of energy and water consumers.

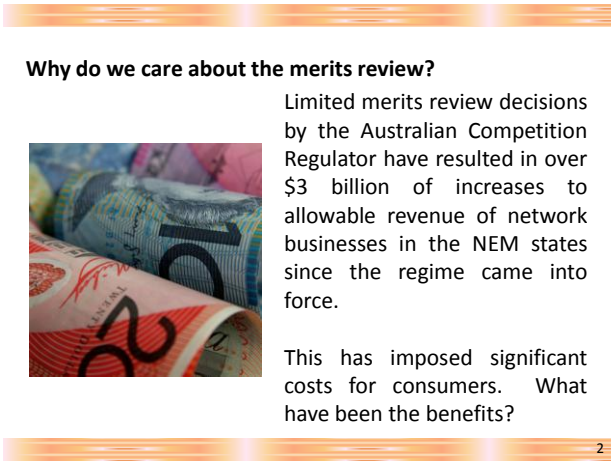
Our work is guided by strong principles. Energy and water services are essential for health, wellbeing and social participation. Therefore, we believe that consumer interests – particularly those of low-income, disadvantaged and rural and regional consumers – must be a primary consideration in the development and

implementation of energy and water policy and in service provision. Our advocacy maintains a focus on the principles of affordability, accessibility, fairness and empowerment through information and education. As part of that, we support informed consumer participation in energy and water markets.

As part of our advocacy on behalf of Victorian electricity consumers we were actively engaged in the Victorian electricity distribution price review (EDPR) process for the period 2011-2015. It was this effort to deliver fair electricity price outcomes for Victorian consumers that ultimately led us to our involvement with the merits review, which has become the inevitable conclusion of these price determination processes.

My presentation today is primarily a narrative of our experiences from our early involvement in this price determination process to our ultimately unsuccessful attempt to participate in the merits review. I believe that this narrative illustrates quite powerfully the manifest flaws in the current limited merits review regime and the appropriateness of reforming that regime in the interests of Australian consumers.

Slide 3 – Why do we care about the merits review?



At this point I would like to quickly digress and discuss the importance of this issue from the pure perspective of cost to consumers. At the time of the publication of the AER's *State of the Energy Market Report,* the merits review process had resulted in an increase to allowable revenues of energy network businesses in the national energy market to the tune of $2.9 billion. Since that time, the results of further merits review decisions in Victoria have pushed this figure above $3 billion. It is appropriate to question the extent to which this substantial sum has increased the reliability and service quality of the National Energy Market's (NEM's) networks. Furthermore, this $3 billion has been one of several contributors to sharply rising energy prices in Australia.

I shall now return to the issue of the EDPR. CUAC participates in EDPR processes as it is really one of the only, if not the only, remaining area where consumer advocacy can have a direct impact on the price/service mix for energy consumers. In Victoria, there are no longer regulated retail price caps but there is no escaping the impact on

retail bills of the underlying network charges. In fact, it is usually estimated that around 50 per cent of a household customer's bill is comprised of network charges. Again quoting from the AER's data, the current five year regulatory cycle has seen $7billion of investment in electricity transmission, $35 billion in electricity distribution and $3 billion in gas distribution. We see no signs that this investment and the significant consumer costs that accompany it show any sign of easing in the near term. Therefore, when the most recent Victorian EDPR came around we rolled up our sleeves and sought to ensure that consumer perspectives were reflected in the outcomes.

In doing this, I think it would be fair to say that we acquitted ourselves well and were given a fair hearing. We provided several submissions to the AER during the process and were active on the consumer consultative committee raising issues that we thought were in the consumer interest. Within the constraints of the rules, we thought the AER's approach to the EDPR was reasonable.

Slide 4 – Total revenue per customer in draft and final decision by company

Total revenue per customer in draft and final decision by company

Distributor	Draft Report	Final Report	Change (%)
Citipower	$3,465	$3,636	4.9%
Powercor	$3,095	$3,380	9.2%
Jemena	$2,830	$3,119	10.2%
SP AusNet	$3,255	$3,778	16.1%
United Energy	$2,239	$2,615	16.8%
Averages	$2,943	$3,296	12.0%

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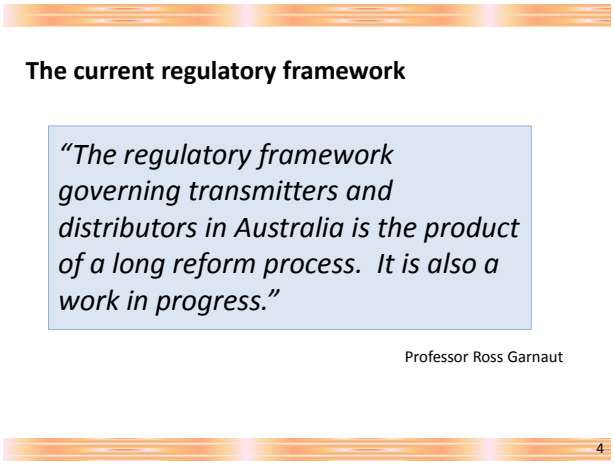
CUAC was relatively satisfied that the AER's final decision and determination for the 2011 - 2015 period was extensive, thorough and in accordance with its regulatory requirements. This table shows the total revenue by customer between the draft and final decision increased costs across all networks, ranging from 4.9% for Citipower to 16.8% for United Energy. It shows how the AER had regard to the positions put by DBs in response to the draft decision to arrive at a balanced final decision.

The process:

- lasted for nearly 23 months (commencing with the preliminary paper on framework and approach – December 2008)
- included AER reports comprising 3894 pages
- elicited 51 submissions from stakeholders (816 pages)
- elicited 15 consultants reports to AER

- included proposals from DBs to the AER totalling 4,632 pages

Slide 5 – The current regulatory framework



Despite the fact that under the current rules CUAC can participate in the EDPR process with the AER and that we regarded the outcome as reasonable, I do not pretend that the current rules are perfect. As Ross Garnaut said in his paper on Transforming the Electricity Sector: *"The regulatory framework governing transmitters and distributors in Australia is the product of a long reform process. It is also a work in progress."* We have been concerned about the increasing complexity of these regulatory processes, the limited discretion afforded to the regulator and the lack of engagement from distribution businesses with consumers in the development of their regulatory proposals. Nonetheless, as we have said, given the rules at the time, we were fairly satisfied with the level of participation afforded to us throughout the regulatory process and thought the process on the whole had been fair and reasonable.

We were, therefore, distressed but not surprised when all five Victorian electricity distributors elected to challenge the AER price determinations. As the AER reports, "the current rules framework has increasingly made reviews of AER decisions an extension of the determination process." As far as we are aware only one distribution pricing determination has not been subject to merits review appeal since the national regulatory regime came into force. As mentioned earlier, this has led to increases in allowable revenues amounting to billions of dollars.

A common sense analysis would suggest that there are flaws in any administrative process that is subject to appeals to a judicial style body with such regularity. Little did we know about the nature and extent of these flaws until we decided, along with our consumer colleagues at the Consumer Action Law Centre, to see if we could further influence the Victorian EDPR process through the merits review.

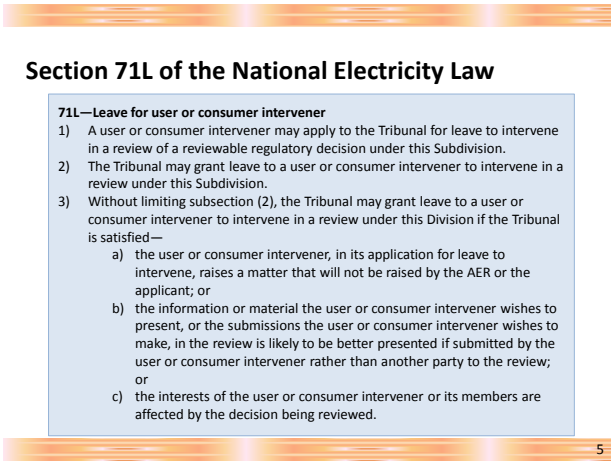
We took this decision because it seemed only reasonable that if consumers had been able to represent the consumer interest in the EDPR until the AER's final decision that they should also have representation during any review of that decision. Furthermore, we were of the view that the AER had responded to distributor concerns with the draft determination and substantially increased the revenue

allowances for the Victorian businesses. We felt that the final determination had struck a reasonable balance between price and service quality and that there would be little consumer benefit from further price increases as a consequence of a lengthy appeal.

In order to try and represent consumer positions in the Merits Review, CUAC and Consumer Action established an "intervention project" to investigate the DBs appeal applications with a view to seeking leave to intervene in the Merits Review on behalf of consumers if warranted. As neither CUAC nor Consumer Action (nor for that matter any advocates for domestic customers had sought leave to intervene previously in the Merits Review) this project had no precedent and we were about to learn some big lessons about the challenges that lay ahead.

We began by investigating the grounds for appeal put forward by the distribution businesses while simultaneously searching for some legal assistance to support us in our analysis. We were quickly confronted by the numerous barriers that make it practically impossible for consumers to participate in merits review processes.

Slide 6 – Section 71L of the National Electricity Law



Negotiating the legal framework for an intervention in the Merits Review requires adequate legal representation and this is prohibitively costly. The DBs and other parties and interveners have legal counsel. This in turn creates constraints on the pool of legal expertise available. CUAC and Consumer Action were successful in quickly gaining pro bono legal advice and senior counsel to assist our intervention. However, it will not always be easy for consumer advocates to do so and represents a considerable resource barrier to consumer intervention. Further, the highly technical nature of the requirements can put heavy demands on a pro bono relationship, particularly if there is limited experience among your legal team of the EDPR.

The legal advice established that the timelines for application to seek leave and the establishment of the grounds for seeking leave to intervene were extremely tight. We were also advised that we would need to have considerable technical expertise to assist our case. We therefore developed and were granted approval for a grant from the Consumer Advocacy Panel to assist our intervention, including funding to

seek expert technical advice. This may not always be available to consumer organisations.

However, it was also clear that because of timelines we were already behind the eight ball in beginning our intervention after the DBs had appealed – an alternative approach is to anticipate an appeal during the price review – but the downside here is mounting a business case for such a project pending an AER decision. I note that the DBs on the other hand do not face the same financial barriers, as these costs are allowable operational expenditure – meaning consumers also pay for the DB appeals.

Access to information also provided a further substantial barrier. In order for the Tribunal to grant a consumer organisation leave to intervene, the National Electricity Law (NEL) requires that it will raise matters that are different to those matters that will be raised by the AER or the DBs or that the material will be presented in a better manner than by other parties.

CUAC and Consumer Action were unable to ascertain what matters the AER and the DBs would raise. DBs and the AER were not forthcoming in providing information once we had announced our intention to intervene. Third parties are not granted access to commercial in confidence information while developing their applications for leave to intervene.

A further financial risk we were advised about from our legal team was that we could be subject to a cost order against our organisations under certain criteria. This risk would be sufficient to deter many community organisations and their Boards from proceeding.

This risk increased as we proceeded with developing our case because of advice that in establishing our grounds for intervention we would need to recruit a well known technical authority on the subject matter of our intervention in order to meet the legal criteria. Both of these present substantial barriers for consumer interventions.

Our legal advice also revealed the actual limits of section 71 L of the NEL. This section in theory allows for consumer representatives to be represented in the merits review. However, in practice the actual scope of this provision is limited.

The view of our legal advisers was that in the context of the NEL, the use of the word "may" in section 71L(2) and (3) gives the Tribunal a discretion as to whether or not to grant leave for a consumer group to intervene. This view is supported by subsections (3) and (4) which set out a non-exhaustive list of factors the Tribunal may take into account in deciding whether or not to grant leave. As such the Tribunal can be expected to make a pragmatic decision in regards to granting leave.

The grounds set out under section 71L(3), whilst non-exhaustive (meaning the Tribunal can take into account other matters), provide strong guidance as to the matter or matters the Tribunal is likely to wish to be satisfied of in order to grant leave, namely that:

(a) the user or consumer intervener, in its application for leave to intervene, raises a matter that will not be raised by the AER or the applicant; **or**

(b) the information or material the user or consumer intervener wishes to present, or the submissions the user or consumer intervener wishes to make, in the review is likely to be better presented if submitted by the user or consumer intervener rather than another party to the review; **or**

(c) the interests of the user or consumer intervener or its members are affected by the decision being reviewed.

CUAC and Consumer Action, along with our legal team and our consultant, pored over the material from the EDPR to establish appropriate grounds for review. Much time was spent indentifying specific, as well as more general issues, which may satisfy the tribunal to give us standing to represent consumer issues.

Despite a thorough analysis of a range of issues in the EDPR our legal team ultimately advised the following:

- The review hearing will be conducted at a very high level of technical and economic complexity;
- Whilst CUAC and Consumer Action would most likely be able to establish, under section 71L(3)(c) of the NEL, that the interests of our constituents may be affected by the decision reviewed, the Tribunal's pragmatic view on granting the application to intervene will ask whether the intervention will add value to the review process, or engage in a manner which is likely to confer a genuine benefit upon those constituents;
- Given the very limited resources available, CUAC and Consumer Action were not in a position to prepare submissions which either grappled with the relevant issues at a sufficient level of detail, or which carried sufficient weight to counter the expert evidence of the Distributors at the review hearing (in practice it was clear in discussions with legal advisers that an expert needed to be world leading to meet this standard);
- These considerations impact negatively upon the prospects of establishing that CUAC and Consumer Action would, as interveners, "raise a matter that will not be raised by the AER or the applicant" as required by section 71L(3)(a) or would present information, material or submissions which were "likely to be better presented if submitted by the user or consumer intervener rather than another party to the review" as required by section 71L(3)(b);
- Accordingly, based on the material prepared by CUAC and Consumer Action it is likely that the Tribunal may acknowledge that a prima facie right to standing as an intervener is made out, but will question the practical utility of exercising such a right given the insufficiencies in the submissions proposed to be advanced once that intervention is granted;

- Thus, it is not clear that the Tribunal would ultimately grant the application to intervene;

- Further, even if the application to intervene were successful, under section 71X of the NEL, costs could be awarded against CUAC and Consumer Action if the Tribunal were of the view that they had conducted their intervention without due regard to the costs and time incurred by other parties as a result of that conduct. Given the hostile posture adopted by certain Distributors in response to the application to intervene, such a costs application is a real risk;

- Weighing up all these considerations, on balance, the application to intervene ought to be withdrawn; and

- If CUAC and Consumer Action nevertheless wanted to continue, they should consider appearing unrepresented, given that public interest organisations that appear without legal representation may be held to less rigorous standards of conduct of a proceeding and may thus be less likely to be the subject of an adverse costs order.

CUAC and Consumer Action staff and our legal team and technical advisors worked assiduously to overcome the range of barriers, both legal and practical. Long hours were put into establishing our legal and technical case, however, as the barriers to our intervention became clearer both organisations had to assess the risks of proceeding against the likelihood of our success. In the end it was with great disappointment that we acknowledged that we had insufficient grounds to succeed and ultimately upon legal advice decided that barriers to consumer participation in the merits review were insurmountable.

In order to maximise the lessons gained from our work, we resubmitted to the CAP to amend our funded project and document the learning from our experiences, providing at the same time an analysis of the Merits Review process and the need for reform to enable some balance for consumer input. The outcome of that revised project was a report documenting our experiences and our concerns with the merits review regime as it currently operates. You can find a copy of that report on our website at www.cuac.org.au.

CUAC believes there are some key policy implications from our experience that need to be factored into the development of a new appeals regime. Happily, late last year the Standing Council of energy and resources announced that it would be bringing forward its review of the merits review regime and an expert panel is currently undertaking that review. We hope that the review will recommend substantial reforms. While we have advocated that a judicial review model would be an appropriate appeals model we are also open to new and innovative approaches to appeals that achieve positive outcomes and maximize consumer involvement. As part of that review process the, expert panel highlighted the original intentions of the review regime as set out by the then Ministerial Council on Energy. These are to:

- maximise accountability

- maximise regulatory certainty;
- maximise the conditions for the decision maker to make the correct initial decision;
- achieving the best decisions possible;
- ensuring all stakeholders interests are taken into account, including those of service and network providers and customers;
- minimizing the risk of gaming; and
- minimizing time delays and costs.

We are of the view that the current merits review regime fails to meet a number of these objectives. The experience that I have highlighted to you all today demonstrates the practical and legal constraints of effective consumer participation in this process. Our lack of success and other poor outcomes for large user interveners underscore how unlikely it is that the current merits review regime will allow for the consideration of all stakeholder interests. The current regime therefore fails on at least one of the objectives highlighted previously on representation of consumers.

We are also of the view that the current regime fails to meet the last two of the objectives around gaming and minimizing delays and costs. The regularity of the appeals and the fact that they have only led to upward price movements suggest that there is an incentive to appeal. The information asymmetry between regulated entity and regulator is obviously a feature in this.

Furthermore, the costs of the appeal itself and the delays it causes to the delivery of the final decision are remarkable. The Victorian EDPR process with five distribution businesses (each with their own legal teams) appealing the decision of the AER and both the AER and the Victorian Minister for Energy and Resources party to the appeal, involved expensive legal resources. Certainty on most aspects the final decision did not come until earlier this year. That is over 12 months after the AER's final decision. Again, common sense would suggest that this approach is not succeeding in minimizing costs and delays.

Slide 7 – Some questions to be considered when developing an appropriate regulatory regime

Some questions to be considered when developing an appropriate regulatory regime

Is it cause for concern that an administrative decision is almost inevitably subject to a costly appeals process?

Given that allowable revenues have only increased as a result of merits review processes, does this mean that the AER only ever errs against the interest of the regulated entities?

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I now have two slides of a number of questions that clearly arise from the information that I have provided to day.

The questions are:

- Is it cause for concern that an administrative decision is almost inevitably subject to a costly appeals process?
- Given that allowable revenues have only increased as a result of merits review processes, does this mean that the AER only ever errs against the interest of the regulated entities?

Slide 8 – Some questions to be considered when developing an appropriate regulatory regime

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Is it acceptable that we have to rely upon the body that made the original decision to act as the primary counterweight to distributor interests in the current merits review regime? Will the AER appeal their own decision if they erred in favour of the regulated businesses?

Is it acceptable that a party that is seriously affected by the outcome of any appeal is practically prevented from participation in that process?

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- Is it acceptable that we have to rely upon the body that made the original decision to act as the primary counterweight to distributor interests in the current merits review regime? Will the AER appeal their own decision if they erred in favour of the regulated businesses?
- Is it acceptable that a party that is seriously affected by the outcome of any appeal is practically prevented from participation in that process?

No doubt we can have a bit of a discussion around these questions when it comes time to open this forum up to the floor. I am sure also that Mr Finkelstein will have some good responses to the questions that I have posed. Nevertheless, we are of the view that our research and experience clearly highlights the need for reform of the current appeals mechanism.

Slide 9

The current limited merits review regime should be replaced with a new system that aligns much more closely with the consumer interest and the principles that were originally established for the operation of the appeals mechanisms under the national energy laws.

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Happily, it seems that the expert panel reviewing the merits review seems to share many of our concerns. In their first report to the Standing Council on Energy and Resources they have found among a range of deficiencies that: the merits review arrangements "have not ensured that all stakeholders' interests have been adequately taken into account,…consumer bodies and network user associations (with justification) feel excluded from the appeals process,… the LMR has been costlier to operate and cases have taken longer than was anticipated at the outset." Consequently the panel has concluded that "a considerable effort is merited in seeking to strengthen the regime, in ways that will allow it to better serve its intended purposes." The expert panel is now in the process of determining what reforms should be made to the regime with a final report due later this year.

As I have mentioned, we have advocated in our research and in our submissions to the expert panel that the limited merits review regime should be replaced with a judicial review that reduces the incentive to appeal. We believe that the scope of a judicial review could be addressed within the NEL to deal with any concerns about this form of review. Having said this, we are open to "appeal" innovations that would truly achieve the original MCE objectives that I outlined earlier and we wish the expert panel well in their ongoing review process. We also hope to provide further input into their deliberations to shape an outcome that is in the consumer interest.