

Judicial Review of energy network regulatory decisions

May 2017

Background

On 23 May 2017, the Full Federal Court rejected an appeal by the Australian Energy Regulator (AER), which will now need to remake its previous decisions on New South Wales and ACT electricity and NSW gas network charges for 2014-2019.

The regulator appealed the findings of the independent Australian Competition Tribunal that found material errors were made in April and May 2015 when the regulator set operating expenditure, debt and tax allowances. The Tribunal found the AER should improve its decision-making processes and remitted the decisions to the AER to be remade.

Question

Who appealed to the Federal Court and what was the Court's decision?

- » The Australian Energy Regulator appealed to the Federal Court against a ruling by the Australian Competition Tribunal made in February 2016.
- » The AER appealed the Tribunal ruling on the basis that the Tribunal had made a legally incorrect decision. This represents a form of 'judicial' review and related to matters of law.
- » The Federal Court decision upheld the Tribunal decisions in its findings on two major matters, relating to:
 - the Tribunal's decision to set aside operating expenditure allowance decisions by the AER, due to finding errors in AER's development and use of economic benchmarking approaches and its interpretation of statutory obligations; and,
 - the Tribunal's decision to set aside AER decisions on the cost of debt allowances, principally due to the AER requiring a transition to a new approach to estimating the cost of debt, despite this being unnecessary and unreasonable based on the existing debt financing practices of the businesses.
- » The Court did find errors in the Tribunal's approach to estimating the future cost of corporate taxation.
- » The decision means that a new AER decision will need to be made which takes into account the correct findings of the Tribunal, and the Court's judgement.

Do the Federal Court and Australian Competition Tribunal decisions require the AER to set higher network charges?

- » Neither the Court nor the Tribunal took the decision out of the hands of the AER.
- » Their judgements do not require the regulator to approve *more* or *less* funding – but simply to make its decisions correctly.

What does this appeal outcome mean for customers?

- » Energy networks appealed to the Tribunal to ensure they could meet customer needs, to keep the lights on, energy reliable and to manage bushfire and other safety risks.
- » Poor regulatory decisions inevitably lead to poor service, reliability impacts and ‘catch up’ spending down the track.
- » It is widely recognised in economic regulation that there are potential cost and service trade-offs to be evaluated in setting expenditures for long-life network services. Customers should not pay any more than necessary for the services that they value. Equally, short-term price reductions that underfund sustainable services have the potential for impacts on customer services and long-term bill outcomes.
- » That judgement should be carefully balanced in expert regulation, which is independently reviewable to avoid material errors.
- » By law, the Competition Tribunal is unable to set aside an AER decision unless it determines not only that there are errors but that a correct decision could produce a materially preferable outcome for customers. The Tribunal made that finding and the Federal Court upheld its decision.
- » Now, guided by the same laws, the AER must remake decisions so as to best serve the long-term interests of customers when applying the Federal Court’s findings.

Will electricity bills go up? Are networks making a wind-fall gain from this decision?

- » Any estimates of bill outcomes are speculative, given the AER will need to remake its decisions taking into account a range of factors including the appeal outcomes.
- » However, New South Wales electricity network businesses do not expect a price shock or major impacts on customer bills. Thanks to a practical approach led by the AER, next year’s prices will not be affected and any adjustments will be phased in over five to seven years.
- » Endeavour Energy expects network charges in its service area to remain steady.
- » On its best current information, Ausgrid expects it may lead to a small increase for customers in its service area of around 1.5% a year for five years.
- » Essential Energy indicates it is unlikely to impact networks charges in its service area in the current regulatory period to 2019.

Does this show network businesses are ‘cherry picking’ the appeal process for their own benefit? Are appeals under limited merits review by networks a “free option” as some have claimed?

- » Some have claimed that the appeals process results in “cherry picking” as networks choose which issues they appeal. They argue, if the network wins, they achieve a preferable outcome for the network business. If they lose, there is no downside for the network business.
- » Cherry picking is not occurring for these key reasons:
 - The Australian Competition Tribunal cannot set aside an AER decision unless it would mean that customers are better off. Precisely to avoid asymmetric outcomes, the Tribunal must determine setting aside the AER decision will result in a materially preferable decision in the long-term interests of customers under the National Electricity Objective (NEO) and National Gas Objective.
 - Customer advocates can – and did – also appeal some of the same decisions. The Public Interest Advocacy Centre described the regulator’s use of benchmarking to set operating expenditures as ‘illogical and arbitrary’.
- » The Federal Court explicitly assessed this claim in its decision [at paragraph 79]:

“The AER referred to the issue of “cherry picking”, and provided an example to illustrate the point. There may be cases where the regulated business sought to correct one error, where there was a matching error or matching generosity elsewhere, such that correcting the error would not result in a materially preferable decision in terms of satisfying the NEO. However, the present case was not such a case. The errors identified by the Tribunal were errors in fundamental aspects of the revenue building blocks, which caused allowable revenue to be materially understated. As the Tribunal recorded at [1221], it was not suggested that any interrelationships or generosities were of such magnitude as to offset the potentially adverse consequences of the established grounds of review.”
- » Contrary to claims that there is “no downside” for networks to undertake a limited merits review – they bear their full costs in the process to correct errors by the Regulator. These costs cannot legally be passed on to customers, even if (as in the recent cases) the AER’s decisions are found to contain material errors.

Is this appeal outcome proof that the regulatory appeal system is broken?

- » The appeal outcome confirms why a merits review scheme is needed – customers are best served when errors in regulatory decision-making are able to be corrected.
- » It shows that regulatory decisions can contain errors that need to be corrected to prevent customers from either paying too much or being exposed to poor service.
- » Energy networks and their customers both want to lower prices while maintaining the safe, reliable and secure electricity service that customers value.
- » The challenge is striking a balance between short-term price reductions and the potential for impacts on customer services and long-term bill outcomes. Lower prices

today don't always mean a win for customers if catch up spending is required down the track.

Do networks pass on the cost of limited merits reviews to customers?

- » Networks will not be passing on the costs of taking part in the limited merits review process whereby they appealed the decisions of the AER, now found to be in error. In fact, networks are prevented from recovering these costs, *by law*.
- » Under judicial reviews like this action, the judge makes a decision on how costs are borne between the appealing party (the AER) and others.

When will customers have certainty about future prices?

- » The Australian Competition Tribunal and the AER will need time to act on the Court's guidance, with the first step being resolution of the Court's orders within 21 days.
- » The relevant energy networks will work closely with the AER which will need to engage with networks and customers on a re-made decision.