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# COMPETITION & REGULATION UPDATE

AMENDMENTS TO THE ELECTRICITY AND GAS LIMITED MERITS REVIEW REGIME:  
IT'S ALL ABOUT THE NEO/NGO

The South Australian parliament yesterday passed amendments to the National Electricity Law (**NEL**) and National Gas Law (**NGL**) to give effect to the policy position of the Standing Council on Energy and Resources (**SCER**) in relation to the limited merits review regime.

While in the course of consulting with stakeholders, the SCER explored radical reforms to the merits review regime, the amendments to the NEL and NGL retain much of the existing regime and focus primarily on ensuring that decisions by regulators and, on review by the Australian Competition Tribunal (**Tribunal**), reflect the overarching primacy of the national electricity objective (**NEO**) and national gas objective (**NGO**).

While DLA Piper does not anticipate the changes will effect radical change to the review rights of regulated energy network businesses, some changes will need to be the subject of consideration by the Tribunal before there can be

any certainty around the operation of the regime. In addition, the longer term future of the merits review regime remains uncertain as the Ministerial Council on Energy must initiate a review of the Tribunal's role under the NEL and NGL by 1 December 2016.

This update outlines what has stayed the same under the limited merits review regime, what has changed and the developments during the SCER's consultation on the NEL and NGL amendments. It also comments on what the changes to the regime mean for energy network businesses and other interested parties that may make an application for review.

## BACKGROUND

On 9 December 2011, the SCER agreed to bring forward the review of the limited merits review regime established by the NEL and NGL.<sup>1</sup>

There was an extensive period of consultation, first before an expert panel appointed by the SCER to

assess the performance of the regime and report on whether any changes to the regime were necessary,<sup>ii</sup> and then before the SCER itself in developing a regulation impact statement.

The SCER explored three options for reform:<sup>iii</sup>

- Option 1: retain the status quo
- Option 2: amend the framework (including by establishing a single ground for review, being whether there is a materially preferable decision) but retain the Tribunal as the review body
- Option 3: amend the framework (as under Option 2) and establish a new review body.

The SCER settled on a revised version of Option 2, that is, amending the existing framework but retaining the Tribunal as the review body.

## AMENDMENTS TO THE MERITS REVIEW REGIME

### What has stayed the same?

Significant elements of the limited merits review regime under the NEL and NGL have remained unchanged. In particular:

- **Tribunal as the review body:** The Tribunal will be retained as the review body, rather than a new review body being created (albeit a review of the Tribunal's role under the limited merits review regime must be initiated by 1 December 2016)
- **"Limited" nature of merits review:** The regime will continue to be a limited merits review regime, rather than allowing for *de novo* review (that is, a hearing of the matter anew)
- **Grounds for review:** The existing grounds for review (broadly, error of fact, incorrect exercise of discretion and unreasonableness) will be retained. Rather than replacing the grounds for review with a single ground for review, the amendments introduce new requirements to be met, in addition to the ground for review (discussed below).

This approach means significantly more certainty for participants to review processes than would have been the case had the more radical reforms consulted on been adopted by the SCER.

### What are the key changes?

The key changes to the limited merits review regime are as follows:

- **Additional leave requirement:** Applicants for review will be required to establish a prima facie case that setting aside or varying the decision, or remitting the matter to the regulator, would result in a materially preferable decision to the regulator's decision in making a contribution to the achievement of the NEO or NGO (as relevant), in order to secure leave to apply for review. The intention is that this will establish a higher threshold for leave than the existing leave requirements (which are that there must be a serious issue to be heard and determined as to whether a ground for review exists and, in the case of grounds that relate to revenue, that the amount specified in or derived from the decision exceeds the lesser of \$5 million or 2% of the average annual regulated revenue of the relevant energy network business)
- **Requirement for materially preferable NEO/NGO decision:** The Tribunal must be satisfied that its decision will deliver a decision that results in a materially preferable decision to the regulator's decision in making a contribution to the achievement of the NEO or NGO (as relevant)
- **Interrelationships:** In varying or setting aside the regulator's decision, the Tribunal must consider (and specify in its decision) how the constituent components of the decision interrelate with each other and with the matters raised as a ground for review, in addition to having the power, as it did under the pre-existing regime, to consider related and consequential matters raised by the regulator
- **New requirement for variation of decision:** Before varying a determination of the

regulator, the Tribunal must satisfy itself that to do so will not require the Tribunal to undertake an assessment of such complexity that the preferable course of action would be to set aside the decision and remit the matter to the regulator to make the decision again, instead of just being required to have regard, as it was under the pre-existing regime, to the nature and relative complexities of the decision and matter the subject of the review

- **New information or material:** Once a ground for review is made out, the Tribunal can have regard to information or material that was not before the regulator if the information or material:
  - was publicly available or known to be available to the regulator when it was making the decision; or
  - would assist the Tribunal on any aspect of the determination and was not unreasonably withheld from the regulator when it was making the decision,

and was (in the opinion of the Tribunal) information or material that the regulator would reasonably have been expected to have considered

- **Consultation with users and consumers:** The Tribunal must take reasonable steps to consult with users of the relevant services and consumers that the Tribunal considers have an interest in the determination or are a party to the review
- **Limited costs orders against small/medium users:** Costs orders against small/medium user or consumer interveners must be limited to the payment of reasonable administrative costs of the other party.

In addition to amendments to the limited merits review regime, the amendments to the NEL and NGL will impact on processes before the regulator. These changes are largely to mirror and support the amendments to the limited merits review regime.

## Developments during SCER's consultation

For those broadly familiar with the outcome of the SCER's review of the limited merits review regime, the SCER's consultation on the draft amendments to the NEL and NGL nonetheless operate to illuminate elements of the new merits review regime.

Developments during the SCER's consultation on the NEL and NGL amendments include:

- **Materially preferable NEO/NGO decision:** The SCER rejected submissions that "materially preferable" should be defined, choosing to leave it for the Tribunal to interpret and apply the term in the absence of any judicial guidance or Australian legislative precedent. The SCER did, however, amend the NEL and NGL as a consequence of consultation to expressly provide that the establishment of a ground for review, consequences for, or impacts on, the average annual regulated revenue of an energy network business and/or whether the amount specified in or derived from the decision exceeds the leave threshold (ie the lesser of \$5 million or 2% of the average annual regulated revenue) must not be determinative of whether a materially preferable NEO/NGO decision exists. This amendment operates to exacerbate, rather than mitigate, the uncertainty
- **Establishment of prima facie case:** Again, the SCER leaves questions such as the extent to which interrelated matters are considered at the leave stage, in deciding whether there is a prima facie case as to the existence of a materially preferable NEO/NGO decision, to the Tribunal
- **Minister can apply for review:** The amendments to the NEL and NGL explicitly allow for the Minister of the participating jurisdiction to apply for review of a decision by the regulator. While the drafting is ambiguous, the SCER's apparent intent is that the Minister may do so only if he or she has made a submission before the regulator,

either within time or outside time but which the regulator chose to take into account

- **"Record" of decision:** Revisions as between the consultation draft of the amendments to the NEL and NGL and the amendments as passed in response to considerable comment on what should constitute "decision related matter" include:
  - Amendments to clarify that a transcript of any meetings or engagements by the regulator of which the Tribunal should be aware forms part of "the record"; "the AER should include anything that was used to inform its decision-making, including conversations with parties, as appropriate"<sup>iv</sup>
  - Submissions that form part of "the record" are not confined to those made within time; "[a]ll matter received by the AER should form the record of the decision-maker"<sup>v</sup>
  - Any reports and material "considered by" the regulator, and not merely those "relied on" as contemplated in the draft amendments, form part of "the record"
  - The inclusion by the draft amendments of "any other material ... the AER considers relevant" in "the record" is removed in the amendments as passed
- **Matters that may be raised in a review:** The amendments as passed go further than the draft amendments in curtailing the matters that may be raised on review by an applicant, providing that, in relation to the issue of whether a ground for review exists or has been made out, an applicant may only raise a matter it has, itself, raised and maintained before the regulator and not any matter subsequently agreed with the regulator, accepted or abandoned, or raised and maintained by another provider. The applicant may, however, raise any matter relevant to the existence of a materially preferable NEO/NGO decision and/or constituent components of the decision that interrelate with a ground for review

- **Review related matter:** The circumstances in which the SCER proposed the Tribunal be permitted to consider new material were unclear from the SCER's regulatory impact statement. The NEL and NGL amendments establish that the Tribunal may do so once a ground is made out, that is, in considering whether a materially preferable NEO/NGO decision exists and/or interrelated matters. In addition, the amendments as passed confer on the Tribunal a discretion to take its own steps to obtain information or material to assist in these circumstances
- **Interrelated matters:** The SCER rejected suggestions it should impose an obligation, rather than confer a discretion, on the regulator to raise interrelated matters. Notwithstanding concern expressed by the AER in consultation, once a ground for review is made out, it is open to an applicant to raise a matter (including a matter that was the subject of a ground for which leave was not granted and/or was not raised before the regulator) as an interrelated matter. The SCER has expressly affirmed its intention that the Tribunal has power, once a ground is made out, to vary the regulator's decision in relation to interrelated matters as well as the ground.<sup>vi</sup>

### What do the amendments mean for energy network businesses and other potential applicants?

The additional leave requirement is unfortunately likely to mean that the leave process remains a relatively time consuming and costly process, rather than being simplified as was advocated during the consultation processes (including by a former President of the Tribunal<sup>vii</sup>).

What will be required to establish that a decision is a materially preferable NEO/NGO decision is uncertain. While the NEO and NGO have always governed the exercise of discretion by the regulator and, on review, the Tribunal, given the amendments to the NEL and NGL, the NEO and NGO can now be expected to feature more prominently in the Tribunal's reasons for decision,

giving effect to the SCER's objective in making the amendments to facilitate public reporting of those decisions.

Broadly, the NEO and NGO state that the objective of the NEL and NGL is to promote efficient investment in, and efficient operation and use of, services for the long term interests of consumers with respect to price, quality, safety, reliability and security of supply. It is accepted that the long term interests of consumers require prices to reflect the long run cost of supply and to support efficient investment by providing investors with a return that covers the opportunity cost of capital required to deliver the relevant services. That is, the long term interests of consumers in the NEO or NGO are broad enough to capture the legitimate interests of regulated businesses.

"Materially" is not defined in the NEL or NGL and how it will be interpreted by the Tribunal remains to be seen. The ordinary meaning of material is "of substantial import or much consequence".<sup>viii</sup>

While on the face of it, the revenue impact would appear to be a key factor in establishing that another decision is "a materially preferable" NEO/NGO decision, the amendments as passed expressly provide that the consequences for revenue must not, in themselves, determine the question about whether a materially preferable NEO/NGO decision exists. This means that applicants for review will need to demonstrate something further. What that something further might be is particularly unclear. It could, however, be as simple as highlighting the consequences of the revenue impact for consumers (eg as a result of the reduction in revenue, the regulated business will not be in a position to meet the required safety standards).

In order to ensure they can satisfy the new review requirements, given the continued restrictions on what can be raised before, and considered by, the Tribunal in review proceedings, potential applicants for review will need to ensure they can establish a prima facie case that setting aside the regulator's decision will deliver a materially preferable NEO/NGO decision on the basis of contentions and materials put to the regulator.

While an applicant will be free to raise any matter, and potentially adduce new information or material, in relation to the existence of a materially preferable NEO/NGO decision once a ground for review is made out, this is not the case at the leave stage and, even once a ground is made out, the introduction of new information or material is limited. Such an approach may also assist the applicant to secure variation of the regulator's decision by the Tribunal, rather than remittal.

The requirement to take into account interrelationships is not new to the merits review regime. The pre-existing regime allowed the regulator to raise, and the Tribunal to consider, matters related to a ground for review or possible outcomes or consequences of the Tribunal's decision. However, the power was not often exercised. While the Tribunal is likely to rely on interested parties to raise any interrelationships between constituent components of the decision (defined as the matters that constitute the elements or components of the decision and on which the decision is based), including an express requirement that the Tribunal consider such interrelationships will mean that such matters are considered as a matter of course during review proceedings.

The limitations on the matters that may be raised on review underline the importance of an energy network business itself raising, and continuing to expressly agitate, any matters of concern to it before the regulator.

The changes made in relation to the information and material that forms part of "the record" to which the Tribunal may permissibly have regard, including those to include in "the record" transcripts of all regulator discussions with stakeholders and all reports and materials "considered", and not merely "relied on", by the regulator, are likely to benefit energy network businesses. This is particularly so given the AEMC's directive to the AER and energy network businesses to engage informally outside the regulatory determination process established by the National Electricity Rules and National Gas Rules.<sup>ix</sup> However, those businesses will need to

ensure engagement with the regulator is confined to representatives of the businesses that are well informed on the matters under discussion. They should also continue to raise matters before, and submit information and material to, the regulator within time because, while submissions out of time will form part of "the record", it will be more difficult to establish error by the regulator in failing to take account of matters, information and/or material lodged out of time.

## WHAT TO WATCH

The key issues to watch going forward will be how the Tribunal:

- **Interprets the leave requirements:** The requirement to establish a prima facie case for a materially preferable NEO/NGO decision at the leave stage will likely require parties to make lengthy submissions to the Tribunal. Given the duplication and other inefficiencies associated with such a process, the Tribunal may give guidance as to what is required for the purposes of meeting these requirements
- **Interprets the meaning of materially preferable NEO/NGO decision:** It is unclear how the Tribunal will go about interpreting the requirement for a materially preferable NEO/NGO decision. The Tribunal can be expected to set out its views in the first review proceeding to be heard under the new provisions
- **Identifies interrelated matters:** While DLA Piper expects the Tribunal will rely on parties to the review proceedings to highlight interrelationships between the constituent components of the regulatory decision, the degree to which the Tribunal independently seeks to identify such interdependencies remains to be seen and may impact on the risks associated with instituting review proceedings.

As noted, a review of the Tribunal's role under the limited merits review provisions of the NEL and NGL must be initiated by 1 December 2016. The

workings of the Tribunal, which is presided over by a member of the Federal Court of Australia, are well known to lawyers practising in the area. Any move by the SCER to replace the Tribunal with a new untested review body or to alter the way in which the Tribunal conducts itself could dramatically change the practical operation of the merits review regime under the NEL and NGL, creating significant uncertainty for all interested parties.

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<sup>i</sup> The review was legislated to be undertaken within seven years after the commencement of the relevant parts of the NEL and NGL (which parts commenced in 2008): s71Z of the NEL; s270 of the NGL.

<sup>ii</sup> The panel was constituted by Professor George Yarrow, the Honourable Michael Egan and Dr John Tamblyn.

<sup>iii</sup> SCER Senior Committee of Officials, Regulation Impact Statement, Limited Merits Review of Decision-Making in the Electricity and Gas Frameworks, Consultation Paper, 14 December 2012.

<sup>iv</sup> SCER, Limited Merits Review Regime, Bulletin Seven, 13 September 2013, p5 of annexed Table

<sup>v</sup> Ibid, p4

<sup>vi</sup> Ibid, p8

<sup>vii</sup> Submission of R Finkelstein QC to the Expert Panel, 12 June 2012, p7.

<sup>viii</sup> Macmillan Publishers Australia, *Macquarie Dictionary* (5th ed, 2009).

<sup>ix</sup> AEMC, 2012 Rule Determination, 29 November 2012, pp169-70.

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