



Australian Competition Tribunal energy merits review decisions

On 26 February 2016, the Australian Competition Tribunal released its decisions in relation to the merits review appeals made by Ausgrid, Endeavour Energy, Essential Energy, ActewAGL, Jemena Gas Networks and the Public Interest Advocacy Centre under the national electricity regulatory framework. The key aspects of the Tribunal's decisions and its implications are summarised below.



Key outcomes

The Tribunal has set aside the AER's final revenue determinations and required them to be re-made in accordance with the Tribunal's reasons and guidance.

Operating expenditure. The AER must re-assess the network service providers' (NSPs) opex forecasts using a wider range of models for benchmarking and also undertake a 'bottom up' assessment of the NSPs' forecasts. This is a highly important decision regarding the appropriate use of economic benchmarking tools in expenditure assessments, in particular, the risks associated with over-reliance on the outcomes derived from such tools.

Return on debt. The AER must reconsider the way in which it implements the new trailing average approach. In simple terms, the Tribunal requires the AER to consider the impacts on the efficient financing costs of the benchmark efficient NSP of the new trailing average methodology and have regard to those impacts in deciding on the transition process to this new methodology.

Gamma. The AER must remake the revenue determinations with a gamma value of something less than the value of 0.4 applied by the AER and most likely 0.25 or something close to that value. The Tribunal found that the AER adopted a conceptual approach to gamma that redefines it as the value of imputation credits that are available for redemption, which is inconsistent with the concept of gamma used in the Officer Framework for the WACC which underlies the National Electricity Rules.

Return on equity. The AER's return on equity decisions stand. Amongst other things, the Tribunal was not satisfied that the ground of review represented by the AER's estimation of an equity beta of 0.7 was in error, notwithstanding forceful submissions to the contrary.



Lessons

The merits review mechanism remains a fundamentally important feature of the national electricity regulatory framework and is an important design feature of all economic regulatory frameworks by mitigating the risk associated with the incorrect exercise of regulatory discretion.

The Tribunal made a number of interesting comments regarding the role of the AER and the current adversarial nature of the national electricity regulatory process. The Tribunal recognised that its role, and the role of the AER is a "delicate task" in that both the interests of consumers and the legitimate business interests of NSPs must be equally considered. It stated that the AER '...should not put itself

in an adversarial position in relation to the DNSP so that it may be perceived as a champion of consumers.’ This is consistent with earlier observations by the High Court in relation to gas access decisions. The Tribunal rightly acknowledges that the AER’s role (and its own) is to balance the interests of consumers and those of the networks that it regulates.

The Tribunal made reference to this balancing act in its assessment of the ‘materially preferable’ threshold for varying or remitting an AER determination. This threshold was introduced into the NER as part of the 2012 rule amendments. This is the first time that this new threshold has been tested.

The Tribunal recognised that there may be two or more possible decisions which may contribute to achievement of the National Electricity Objective/National Gas Objective. The AER’s role involves balancing a range of factors and selecting the decision that best achieves the NEO/NGO. In saying this, the Tribunal recognised the many inter-relationships within the regulatory building blocks. The Tribunal identified that the fundamental question is whether the AER made a decision that was “erroneous” when carrying out the balancing exercise, and that this would have adverse consequences for the long term interests of consumers. The Tribunal concluded that the AER reached its decisions based on complex facts and/or the exercise of its discretion that were not properly established and on this basis set aside the AER’s decisions.

It is to be hoped that this set of Tribunal decisions will provide sufficient guidance regarding how the opex assessment and rate of return rules should be interpreted in future to reduce the need for appeals.



Next steps

The AER is now required to re-make its revenue determinations for the appellant networks. However, it is unclear how the AER will exercise its discretion in remaking its decisions. As a result, it is not clear what the revenue impact of the decisions will be except that they will be higher than the AER’s original final determinations.



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