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By Email

Dear Rick

Confidential and privileged

Binding rate of return instrument

You have asked us to consider and advise you on the latest proposed draft of the *Statutes Amendment (National Energy Laws) (Binding Rate of Return Instrument) Bill 2018* (SA) (**Bill**),[1] under which the Australian Energy Regulator (**AER**) will determine rate of return instruments.

The current drafting of the Bill is unlikely to achieve the Energy Council's objectives

We understand that the Council of Australian Governments Energy Council's (**Energy Council**) intends that the Bill provide that such instruments will be binding on the AER and network service providers (**NSPs**), consistent with the revenue and pricing principles[2] and reviewable if they are not.

In our view, as currently drafted, the Bill will not achieve the Energy Council's objectives.

(a) **AER rate of return instruments do not need to be unreviewable legislative instruments to be binding.**

Delegated or subordinate legislation is a form of legislation made by persons or bodies other than Parliament who have been given the authority to make such legislation by an Act of Parliament (referred to as 'primary legislation'). Delegated legislation (also referred to as 'subordinate legislation') consists of instruments which lay down general rules of conduct affecting the community. The administrative function embodied in delegated legislation consists in the application of general rules to particular cases.

Under the current Bill, a rate of return instrument made by the AER[3] will, in our view, be a form of delegated legislation. As a consequence, an instrument will only be reviewable on extremely limited, judicial review grounds. Australian courts have limited jurisdiction to rule on the validity of delegated legislation so that in deciding on the validity of an instrument, the court has a threefold task:

- determine the meaning and scope of the words used in the empowering or enabling Act of Parliament under which the delegated legislation is made;

[1] While not yet publicly available, the latest draft Bill was provided to Spark Infrastructure as part of a workshop on the binding rate of return instrument.

[2] See National Electricity Law (**NEL**) s 7A and National Gas Law (**NGL**) s 24.

[3] Under proposed NEL s 18I(2) and NGL s 30D, as applicable.

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- determine the meaning and scope of the delegated legislation in question; and
- determine whether or not the delegated legislation comes within the words used in the empowering Act.

Broader grounds of judicial review that apply to other regulatory and administrative decisions will not be available.

It has been argued that the Bill must characterise the instrument as delegated legislation, because this is necessary to make the instrument binding on the AER and NSPs. This is incorrect and inconsistent with other provisions in the NEL and NGL. Numerous and significant AER administrative determinations under the NEL and NGL are made effectively binding because the NEL and NGL provide that non-compliance is a contravention of the relevant Act and subject to substantial civil penalties. For example, AER distribution and transmission revenue determinations made under chapters 6 and 6A of the NER, and access arrangement determinations of the AER under part 8 of the NGR are both enforceable and are administrative decisions, and therefore may be reviewed under broader judicial review grounds that apply to administrative decisions.

(b) **The amendment to the Bill to require the AER to have regard to the pricing principles will not prevent the AER making unreasonable rate of return instruments.**

The Bill provides that the AER '*must have regard to'* the revenue and pricing principles, as well as '*other information*' it considers appropriate.[4] From a judicial review perspective, this provision merely requires the AER to give consideration to the revenue and pricing principles;[5] it does not require the AER to place any particular weight on those principles.[6] That is, the AER can give consideration to the revenue and pricing principles, but then decide to make a rate of return instrument that is not consistent with the principles.

The lack of primacy of the revenue and pricing principles in the Bill is demonstrated by the requirement that the AER must also have regard to '*other information*'. It is entirely possible that the revenue and pricing principles will point in one direction, and the other information in another. This suggests that the AER must have the power to take a factor, such as the revenue and pricing principles, into account and then decide that it is outweighed by competing interests.

Further, many of the revenue and pricing principles are drafted in aspirational rather than mandatory language,[7] and so are unlikely to provide the clear, specific statutory criteria that the law would require the AER to adhere to in framing the rate of return instruments.

The revenue and pricing principles themselves have limited if any relevance to a rate of return instrument determination. The only potentially relevant reference is to '*efficient costs*' and the reference to a '*return commensurate with the regulatory and commercial risks*' involved in providing the service,[8] but

[4] Proposed NEL s 18I(4)(a) and NGL s 30D(4)(a).

[5] *Tickner v Chapman* (1995) 57 FCR 451 at 462; *Minister for Immigration v Jia Legeng* (2001) 205 CLR 507 at [105].

[6] *Minister for Immigration and Citizenship v Khadgi* [2010] FCAFC 145 at [57]-[58].

[7] The principles in NEL, s 7A(4), (6) and (7) and NGL, s 24(4), (6) and (7) are permissive, providing that "regard should be had" to certain matters. NEL, s 7A(2), (3) and (5) and NGL, s 24(2), (3) and (5) are arguably aspirational in nature, given the use of the word "should".

[8] NEL, s 7A(2) and (5), and NGL, s 24(2) and (5).

these phrases are likely too abstract and vague or aspirational to provide a mandatory framework to the AER's decision-making.

Where legislative provisions empowering the making of legislative instruments contain factors that are specifically identified and substantively relevant to the content of the legislative instrument then the law will require the maker of the legislative instrument to give that criteria weight as a fundamental element in the decision-making process.[9] An equivalent formulation is that the matter so identified must be the focal point of the decision-making process.[10]

Proposed amendments to make the Bill consistent with the Energy Council's objectives

To address these issues, we propose a limited number of straight-forward amendments, for the Energy Council's consideration:

(a) That the Bill make the instrument an administrative decision (while still retaining the instrument's binding character by inserting in the NEL and NGL a provision that makes non-compliance a contravention of the relevant Act).

(b) That the Bill require that a rate of return instrument made by the AER 'achieve' or 'be consistent with' the revenue and pricing principles, and the National Electricity Objective and National Gas Objective (as applicable).

(c) That the Bill amend the revenue and pricing principle in 7A(5) of the NEL and 24(5) of the NGL to provide specific guidance (in mandatory language) relevant to rate of return instrument determinations – for example, based on the pricing principles in the *Competition and Consumer Act 2010* (Cth):[11]

> *The [regulated network service provider / service provider] must be provided with a return on investment:*
>
> *(i) commensurate with the regulatory and commercial risks involved; and*
>
> *(ii) that provides incentives to reduce costs or otherwise improve productivity.*

Alternative to amending the revenue and pricing principles in the NEL and NGL, these principles could be included as additional factors in proposed section 18I(4) of the NEL and proposed section 30D(4) of the NGL provided that the reference to '*have regard to*' is amended to 'achieve' or 'be consistent with' (as described in (b) above) and the requirement to have regard to '*other information*' is removed.

If these amendments to the Bill are adopted the legitimate concern of investors that the AER is not subject to any meaningful restraint or guidance in determining the rate of return will be addressed.

Other proposed amendments to the Bill

We also raise a number of other issues in relation to the Bill:

- Proposed sections 18M(2) and 18O(2) of the NEL and sections 30H(2) and 30J(2) of the NGL provide that a person may only make a submission after the stated period with the approval of the AER. We note that there is no absolute

[9] *R v Hunt; Ex parte Sean Investments Pty Ltd* [1979] HCA 32; (1979) 180 CLR 322 at 329; *R v Toohey; Ex parte Meneling Station Pty Ltd* [1982] HCA 69; (1982) 158 CLR 327 at 333, 337-338; *Zhang v Canterbury City Council* [2001] NSWCA 167; (2001) 51 NSWLR 589 at [71]- [73]).

[10] See *Evans v Marmont* [1997] NSWSC 331; (1997) 42 NSWLR 70 at 79-80; *Commissioner of Police (NSW) v Industrial Relations Commission (NSW)* [2009] NSWCA 198 at [73] (Spigelman CJ, Macfarlan and Young JJA agreeing.

[11] See CCA, s 44ZZCA.

- prohibition in the NEL or NGL, or the NER or NGR in relation to late submissions in the process for making revenue determinations. The different treatment of the right to make submissions is incongruous. Clauses 6.14 and 6A.16 of the NER provide the AER with discretion to consider any late submissions when making a distribution determination or transmission determination. The effect of the proposed sections is likely to be similar to these clauses of the NER.
- Proposed section 18P of the NEL and section 30K of the NGL require the AER to establish an independent panel to provide a written report on the draft rate of return instrument. The AER must have regard to that report when making the rate of return instrument under proposed sections 18L of the NEL and 30G of the NGL. While the AER is required to publish the expert report on its website under proposed sections 18P(6) of the NEL and 30K(6) of the NGL, no time frame is specified for the AER to do so. We consider that a timeframe should be specified in the legislation to allow participants in the process to assess the consequences of the report for the final rate of return instrument. Submissions on the expert report should also be permitted.
- The AER's ability to re-open the rate of return instrument if the AER is satisfied that re-opening the rate of return instrument will, or is likely to, contribute to the achievement of the National Electricity Objective or National Gas Objective in proposed sections 18U of the NEL and 30P of the NGL has been removed. This is inconsistent with clause 6.2.8(e) and 6A.2.3(e) of the NER, and clause 87(17) of the NGR), which provide for the current rate of return guideline to be amended from time to time.
- Proposed section 43A of the NEL and 24 of the NGL preserve a rate of return instrument that has been found to be invalid by a court until the invalid instrument is replaced. Any determinations affected by the invalid instrument will be updated to take account of the replacement instrument once made. An invalid instrument would not otherwise continue to apply normally, which creates uncertainties as to what should apply in its place until a replacement (and valid) instrument has been made. We note that there are a number of details that are absent from these proposed sections. In particular, the timeframe within which a replacement instrument must be made and how a network service provider is able to recover the rate of return not permitted by the invalid instrument, but permitted by a replacement instrument, if there is a change in regulatory control period for the network service provider prior to the replacement instrument being made.

Yours sincerely

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